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American capitalism takes a beating

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Full contents
Enlarge current cover
Past issues/regional covers
Subscribe

GLOBAL AGENDA

POLITICS THIS WEEK

BUSINESS THIS WEEK

OPINION
Leaders
Letters

WORLD
United States
The Americas
Asia
Middle East & Africa
Europe
Britain
Country Briefings
Cities Guide

SURVEYS

BUSINESS
Management Reading
Business Education
Executive Dialogue

FINANCE & ECONOMICS
Economics Focus
Economics A-Z

SCIENCE & TECHNOLOGY
Technology Quarterly

PEOPLE
Obituary

BOOKS & ARTS
Style Guide

MARKETS & DATA
Weekly Indicators
Currencies
Big Mac Index

DIVERSIONS

RESEARCH TOOLS

CLASSIFIEDS

DELIVERY OPTIONS
E-mail Newsletters
Mobile Edition
RSS Feeds

ONLINE FEATURES
Cities Guide Go
Country Briefings Go
Audio interviews Go
Classifieds Go

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Print Edition July 13th 2002

Thumped
But don't write off American capitalism just yet ... More on this week's lead article

The world this week

Politics this week
Business this week

Leaders

American capitalism
Thumped

Farm subsidies
Cleansing the Augean stables

Terrorism in Spain
Banning Batasuna

Japan
A dashing disappointment

Afghanistan
A little less bombing, please

AIDS
The long war

Letters

On corporate governance, WorldCom, Kenya, Arab identity, the Cuban missile crisis, buggy software, Rule 110, goals

Special Report

Bush and Big Business
The unlikeliest scourge

United States

State budgets
Tangled up in red

Tobacco taxes
Smokes on the water

Race and policing
Inspector Morse strikes again

The Republicans in Illinois
Ryan v Ryan

A mess in Arkansas
E-nailed

American sports
Balls, pills and dollars

Competitive eating
A man who can stomach New York

Lexington
A prophet without honour?

Correction

The Americas

Reform in Mexico
Where energy is sacred

Politics in Brazil
Pacting with the enemy

The Galapagos Islands
Troubled waters

Colombia's conflicts
The battle of Medellin

Panama's foreign policy
Which China card?

Asia

Afghanistan
Murder in a "safe" city

Indonesia
A direct insult

India and Pakistan
A change of mood over Kashmir

Previous print editions
Jul 6th 2002
Jun 29th 2002
Jun 22nd 2002
Jun 15th 2002
Jun 8th 2002
More print editions and covers »

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Business

Pharmaceuticals
Mercky prospects

Elan
Shame about the name

Reliance
Dynastic progression

European companies
Not so different after all

German corporate failures
Sunken treasure

Internet firms
Be my PayPal

Steel
Brazil, where the slabs come from

Face value
His high-tech Highness

Finance & Economics

Bank reform in Japan
Hampered

Mortgages in Japan
New loans for old

Contrarian investors
A long-distance call

Canada's securities markets
Thirteen into one won't go

Cocoa
Bouncing beans

Auditing
It could happen here

Crédit Lyonnais
Questions, questions

Economics focus
Taken for a ride

Science & Technology

Human evolution
In the beginning

AIDS
Hope for the best. Prepare for the worst

Books & Arts

Political essays
Conversations with the dead

States and wars
Marketing the nation

Graceful arches
American bridges

New fiction
Fields of dreams

Women in China
Unenviable lives

Submarine films
Iron coffins

Obituary

Duke of Norfolk

Philippines
Americans are going home

Japan
Taxing problems

China
Sex of a cultural sort in Shanghai

Middle East & Africa

Algeria's violence
The horrors of war aren't over yet

Palestinian leadership
Arafat's fight for survival

Iraq, Jordan and America
A horrid sandwich

Madagascar at peace
A president flees, another celebrates

African Union
Try, try again

Europe

Europe's farms
Will these modest proposals provoke mayhem down on the farm?

Justice in France
Soft on politicians, hard on the rest?

An Irish scandal
The fortunate Cayman Islands

Greece and terrorism
A breakthrough beckons

Germany's next government
Kaleidoscope

Poland's rocky government
Bad vibrations

Charlemagne
The Netherlands' Jan Peter Balkenende

Britain

Saving
Cutting through the jungle

Fund management
Actively cheated

Academia and politics
Only translate

Selling Britain
The shock of the old

Social housing
Déjà vu

Parliament
Blair's poodle bites

The north-east
The fall of the Halls

Bagehot
Are they turning on Tony?

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Economic and Financial Indicators

Overview

Output, demand and jobs

Prices and wages

Portfolio poll

Money and interest rates

The Economist commodity price index

Stockmarkets

Trade, exchange rates and budgets

Commercial property prices

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Economy

Financial markets

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Politics this week

Jul 11th 2002
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Murder in Afghanistan

EPA

Abdul Qadir, a vice-president of **Afghanistan**, was assassinated by gunmen in Kabul, damaging the authority of the fledgling government of President Hamid Karzai.

See article: Fragile Afghanistan

America modified its position on the **International Criminal Court**, telling the UN Security Council that it no longer demanded permanent immunity for its soldiers serving as peacekeepers. But it still wants to prevent any prosecution of peacekeepers for a year, subject to renewal. Negotiations continued.

Israel's cabinet voted to support a bill brought by a right-wing member of the Knesset that would allow state land to be used exclusively by Jews. Left-wing politicians and civil-rights groups have objected.

See article: The Palestinian leadership

The two **Koreas** were again in dispute when the North accused the South of sending two warships into its territorial waters in the Yellow Sea. “Premeditated provocation,” said the North. On June 29th a South Korean ship sank and four sailors died in a clash with the North.

At last, a winner

Madagascar's low-intensity civil conflict came to an end, after Didier Ratsiraka, one of two men claiming the presidency, fled the country. His rival, Marc Ravalomanana, swiftly won control of the whole island.

See article: Madagascar's civil war fizzles

An influential prelate, Ayatollah Jalaluddin Taheri, resigned as Friday prayer leader in Isfahan after delivering a blistering indictment of **Iran's** rulers, in which he gave warning of a flood of resentment at corruption and misrule.

The Organisation of Africa Unity became the **African Union**, a body whose members promise to uphold democracy and good governance.

See article: The new African Union

Winnie Madikizela-Mandela, a South African politician and ex-wife of Nelson Mandela, went on trial on 85 counts of fraud.

Reports suggested that the United States wanted to use **Jordan** for an attack on Iraq. Jordan denied it would be a launching-pad.

See article: Jordan, Iraq and America

The discovery of a 7m-year-old skull in **Chad** helped to fill a gap in the history of human evolution. The skull, which has a mixture of ape-like and human-like

features, is probably not a direct human ancestor. But it is the only relevant fossil evidence to have been found from this period.

Sick man of Europe

Turkey's three-party coalition headed by Bulent Ecevit was set to fall, after a mutiny within his own party against the ailing 77-year-old prime minister. Several ministers, including the foreign minister and a deputy prime minister, resigned; the economy minister, Kemal Dervis, who is regarded as the key to Turkey's economic reforms, seemed about to follow suit, then apparently changed his mind. The leaders of the two other ruling coalition parties called for an early election. Chaos and uncertainty prevailed.

See article: Turkey in crisis

The European Commission unveiled proposals to reform, modestly, Europe's **common agricultural policy**. The main idea is to unlink subsidies and production. The French, among others, will resist the changes.

See article: Farm subsidies

In a cabinet reshuffle, **Spain's** foreign minister, Josep Pique, lost his post to Ana Palacio, a Euro-MP. The justice minister, Angel Acebes, architect of a new law making it easier to ban Batasuna, the political wing of ETA, the Basque-separatist terrorist group, was promoted to minister of the interior. His main job: to crush ETA, already hurt by a judge-ordered freeze on Batasuna's bank accounts.

See article: Should Spain ban the terrorists' political party?

After years of investigation, a report named 179 members of the **Irish elite** who in earlier decades found it convenient to do business with a firm called Ansbacher Cayman. Any connection with their tax affairs? Not for us to say, said the investigators.

See article: A tax scandal for Ireland's elite

Britain's government said it would decriminalise the possession and use of **cannabis**. But dealers in drugs, supposedly, will still be chased even harder than now.

After years of getting nowhere, **Greek** police caught an alleged member of the November 17th terrorist organisation and reckoned it might soon catch others.

Second place

The final tally of voting in **Bolivia's** presidential election showed that Evo Morales, a left-wing leader of coca farmers, had snatched second place, with 21%. Gonzalo Sanchez de Lozada, a liberal former president, won 22.5%. Bolivia's newly-elected Congress will choose between the two; it is likely to give the nod to Mr Sanchez.

Vicente Fox, **Mexico's** president, said he had secured an all-party agreement in the opposition-controlled Congress to study his government's proposed energy reforms.

See article: Reforming Mexico's energy industries

Carlos Reutemann, a Peronist provincial governor and former racing driver, said he would not stand for **Argentina's** presidency in an election due in March. He had been seen as the strongest moderate candidate.

Zero tolerance

AP

Amateur footage of a handcuffed **black teenager** being thrown against a car and punched in the face by a white policeman in California was shown on national television. Lawyers for Donovan Chavez, 16, say he did not understand what was happening; the policemen say he had attacked them. Meanwhile another video emerged of police beating a 50-year-old black man in Oklahoma.

See article: Law enforcement in Los Angeles

Defying the White House, the House of Representatives voted overwhelmingly for a bill that would let airline pilots carry **guns in cockpits**.

The Senate approved plans to store **nuclear waste** from 39 states inside Yucca Mountain in Nevada, only 145km (90 miles) north-west of Las Vegas. Nevada officials promised to go to court to prevent 77,000 tonnes of radioactive material being buried there from 2010.

No mercy

Malaysia's highest court dismissed an appeal by **Anwar Ibrahim** against a conviction for abuse of power. Mr Anwar, a former deputy prime minister, is regarded by humanitarian organisations as a political prisoner.

Peace talks to end **Sri Lanka's** civil war between the government and the separatist Tamil Tigers, delayed since May, are not now expected to start until August at the earliest.

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Business this week

Jul 11th 2002
From The Economist print edition

Corporate crackdown

George Bush proposed tough measures to restore confidence in America's companies and markets. They include a doubling of jail sentences for corporate fraud to ten years and the setting-up of a new task-force to operate “as a financial-crime SWAT team”. The Democrats complained that he had said too little about stock options and audit reform; they pushed an amendment through the Senate calling for tougher anti-fraud measures.

See article: George Bush and corporate America

Despite the president's speech, **stockmarkets** continued to slide. The Dow Jones Industrial Average fell below 9,000 for the first time since its post-September 11th low. The wider S&P 500 index and the Nasdaq Composite index both fell to around five-year lows.

A Washington-based legal watchdog, Judicial Watch, filed suit against Vice-President **Dick Cheney** over alleged fraudulent accounting practices at Halliburton, an oil-services company that Mr Cheney ran for five years.

Merck revealed that it had recorded $12.4 billion in revenues that it had never actually received. The drug maker defended itself by saying the revenues did not affect earnings and the move was in line with generally accepted accounting principles. Regulators are also looking into the accounting practices of **Bristol-Myers Squibb**, another pharmaceuticals firm.

See article: Mercky prospects

Elan, a struggling Irish pharmaceutical firm, announced that it would sell assets to raise $1 billion in cash after its two top executives resigned. Accounting scandals and worries about a cash crunch chopped 96% off Elan's share price this year.

See article: Elan sheds its boss

A criminal investigation has been launched into the activities of **Qwest Communications**, a troubled American telecoms company.

Online merger

EBay, the world's biggest online auction firm, is to buy PayPal, the world's biggest online payment system, for $1.5 billion in stock. The move reflects the inadequacy of eBay's current payment system, as the firm aims to triple its sales to $3 billion by the end of 2005.

See article: eBay acquires PayPal

In a sign that the fortunes of telecoms firms may be heading for a turnaround, **Warren Buffett**'s company, Berkshire Hathaway, and two other large investors will make a $500m investment in Level 3 Communications. The surprise move may ignite a wave of consolidation among struggling telecoms firms.

See article: Contrarian investors

Bank of China hopes to raise $3.2 billion from an initial public offering of shares in its Hong Kong subsidiary. But the timing may not be propitious: last month the bank announced that profits had tumbled by 47% last year.

Sacking Sommer?

Speculation intensified that Ron Sommer, chief executive officer of **Deutsche Telekom**, would be sacked. Once seen as a visionary who would transform DT into a global giant, Mr Sommer has come under increasing criticism as the company's debts mount and the share price plummets.

See article: Not so different after all

Boeing, the world's largest aircraft maker, said that it will merge its space and communications unit with its military aircraft and missiles division. “We are aligning our business today with the way we believe future systems are going to be designed, acquired and maintained,” said Phil Condit, Boeing's boss.

Shares in **Wyeth** and **Noven Pharmaceuticals** fell sharply on a report that women who use combination hormone-replacement therapy may be at risk of cardiovascular disease and breast cancer. Wyeth and Noven are both makers of hormone-replacement therapies.

Revving up

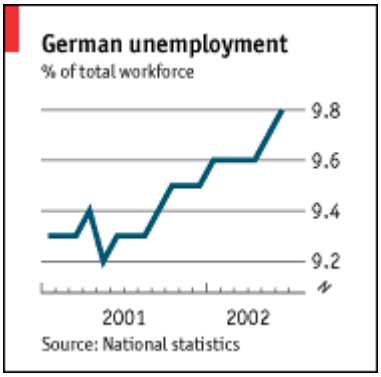
Honda announced that it will invest $480m to raise production capacity in North America. The Japanese car maker is experiencing surging demand for its cars and light trucks just as its competitors are seeing sales sag.

Despite a worldwide downturn in the electronics industry, Japanese **chip makers** said that they are seeing strong sales growth, after a year of abysmal results. Sales were buoyed by the chip firms' greater reliance on demand from consumer-electronics companies rather than personal-computer makers.

The Commerce Department said that **inventories** of American companies rose in May for the first time in a year, as sales declined for the first time since December.

Jobless in Germany

Hopes for a German economic recovery in the second half of the year faded after the Bundesbank reported that the **unemployment** rate climbed to 9.8% in June, the highest since March 2000. Industrial output fell by 1.3% in May, worse than predicted.



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American capitalism

Thumped

Jul 11th 2002
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But don't write off American capitalism just yet

"THE American economy is the most creative and enterprising and productive system ever devised," George Bush told a Wall Street audience this week, before moving on to acknowledge some recent embarrassments. He was right about this, of course. The anguish of some American commentators over the spate of corporate scandals and over what these reveal about the supposedly rotten core of American capitalism is about as exaggerated—and in many cases as downright phoney—as the corresponding delight of their European counterparts. An intelligent response to the Enrons and WorldComs needs to begin by acknowledging the strengths of America's basic model and the dangers of attempting to fix what is not broken. Equally, though, the scandals do show that repairs are needed if the most creative, enterprising and productive system ever devised is to realise its full potential.

A good deal of what went on in American (and European) boardrooms in the latter part of the 1990s, which is only now coming to light, should be regarded as no great surprise. This is not the first time that the mania accompanying a speculative bubble—in this case, in shares in "new economy" businesses—has induced a willing suspension of disbelief in almost all quarters. It is true that bosses of companies such as Enron and WorldCom violated investors' trust and brought ruin on their companies' owners. It is right that, having been found out, they should be punished, not excused. But everybody should at least bear in mind that these benders and breakers of the law had lots of help—not just from the auditing profession, which stands alongside them in the dock, but from many of the same people now crying out for retribution.

Hucksters turned preachers

If you think back to the mood, pre-bust, you will recall that every kind of analyst (with a mere handful of noble exceptions) was cheering the market on, creating an atmosphere in which anything less than double-digit growth in profits was regarded as a sign of timidity. The media stoked the fires of impossible expectations with an unfailing supply of corporate hero-worship; with their mindless praise for innovation (however worthless); with news for day traders, new-economy stockmarket indices and the rest; with their idiotic dedication to the maxim that you either get it or don't get it. At critical moments even the Federal Reserve added fuel. And investors themselves were so entranced by their surging wealth that they more or less willed companies to lie to them. "Pro forma" earnings? Fine. Bald-faced deception? Pile it on. Whatever it takes to keep the good news coming.

Back then the proposal to "expense" stock options (that is, to charge their cost against profits), an idea now widely supported as a good way to make accounts truer, was attacked from all sides—by Democrats as well as Republicans, by many of the same pundits who are now crying out for wholesale regulation of corporate decision-making, and by most new-economy investors themselves. Why? Because this change would have been something of a nuisance for the new miracle companies on which America's future was said to depend. That trumped all counter-arguments.

In truth, the most effective remedy for these ethical and mental breakdowns has already been dispensed, frustrating as this is for politicians with careers to make. Shares may still be dear, but the technology-stock bubble has well and truly burst. The mood has changed from mania to remorse. Until further

notice, regulation or no regulation, investors will be on their guard, and financial orthodoxy and corporate probity will once again be celebrated and valued.

It is in the nature of capitalism to make progress in fits and starts. To some degree, lurching cycles of sentiment are part of the process—the price paid for superior long-term performance. It would be unwise to expect them ever to be eliminated, and rash to try. Still, this boom-and-bust cycle has revealed weaknesses in corporate governance and supervision that can and should be remedied. A few things *are* broken, and should be fixed. These tweaks would not make American capitalism less American: they would make it truer to its own principles. If they can be done, it will work even better.

Fixing weaknesses in corporate governance and supervision will not make American capitalism less American: it will make it truer to its own principles

A curse on interesting accountants

So far as outright fraud is concerned, the laws are there already. As Mr Bush said this week, they need to be more vigorously enforced; a few exemplary jail sentences would be welcome. But that aside, the most important remediable failures of corporate America fall into three overlapping categories: audit, independent directors and bosses' pay. In all three, the need is not to dictate to companies, but to help shareholders do a better job of protecting their own interests, should they be in the mood to try.

Auditing is dull—or damned well ought to be. Shareholders are helpless if they cannot rely on the unvarnished accuracy of the numbers their managers show them. The desire of the accounting profession to express flair and originality must be quashed, and the conflict of interest that arises when managers in effect appoint and pay their own auditors must be resolved. The elements of a minimum reform ought to be: prohibition of non-audit work for audit clients; mandatory rotation of auditors; and the creation of an official oversight body. The Senate audit-reform bill sponsored by Paul Sarbanes is stronger than the House of Representatives' plan, but even it falls short. The White House, ever prone to confuse what is good for chief executives with what is good for the economy, regards the Sarbanes bill as too tough (see article).

On independent directors, what the president said this week was better. He called on stock exchanges to require companies to appoint a majority of independent (non-executive) directors, and for audit and remuneration committees to be all independent. However, here too Mr Bush should have gone further. Independent directors on main boards ought to be required to meet regularly without executive directors present: otherwise, they will find themselves too easily led by the chief executive and his acolytes. Their job is not to nod in approval, but to hold executives to account on shareholders' behalf. In private, they can better remind themselves of this and gird themselves up to keep the boss in his place.

If non-executive directors were more forceful, and if remuneration committees were independent, the problem of scandalously ill-designed pay schemes for top executives would be closer to being solved. Is this really a problem, though, or just the market at work? You bet it's a problem when failed executives who have driven their companies and their shareholders to ruin pocket vast bonuses. This is not the market working; it is the market failing (see article). The remedy is disclosure, honest accounting, non-executive directors empowered to do their job—and, as always, sceptical shareholders looking out for their own interests.

Without doubt, the last of these is the most important of all. Alas, it is beyond the reach of regulators and legislators. For that reason, do not expect too much of the current zeal for reform. The most important lesson of this bust, like every previous bust, is: buyer beware. It will be forgotten again, obviously. But one can savour the clarity while it lasts.

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Farm subsidies

Cleansing the Augean stables

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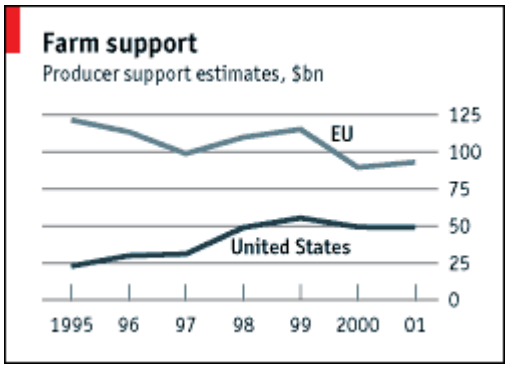
Europe must not put off reforming the common agricultural policy

Get article background

FARMING may be the oldest of economic activities. It also accounts for an ever-decreasing share of rich countries' output and employment. So it is strange that agriculture should now lie at the heart of two big global projects of the next year or so: the Doha round of trade talks and the eastward expansion of the European Union. But so it does; and hence the crucial importance of this week's proposals by the European Commission to reform the EU's common agricultural policy (CAP).

Since its inception, the CAP has been one of the biggest public-policy disasters in the rich world. It has been hugely expensive for taxpayers and consumers. It takes up half the EU budget, although farmers are less than 5% of the workforce. It keeps food prices in Europe far above world levels. It has produced big surpluses that have been exported with subsidies. It has badly hurt farmers in poor countries, who have not only seen exports shut out by European tariffs but also suffered at home from dumped surpluses. As if all this is not enough, the CAP has failed in its main aim of protecting small farmers' incomes, which have fallen inexorably throughout Europe, driving people off the land and encouraging the consolidation of farms into large agribusinesses.

Set against this long catalogue of failings, how do the commission's reform proposals look? The surprising answer is, not at all bad (see article). Admittedly, they do not cut the overall CAP budget, which is a pity. But they trim guaranteed prices, and they firmly continue the trend, set by the McSharry reforms of the early 1990s, of shifting support from subsidies linked to production towards direct income payments to farmers. Indeed, the commission plan is eventually to sever the link between subsidy and production altogether; instead, taxpayers' support is to be directed, far more defensibly, at environmental goals and rural development. This “decoupling” is vital for the liberalisation of farm trade, a key objective of developing countries in the Doha round, which is due to discuss the phasing out of export subsidies.



Moreover, under the commission's proposals, a chunk of the support for rural development and the environment would be paid by national governments, not by Brussels. This step towards a partial renationalising is a welcome move away from one of the most pernicious features of the CAP, which is that it redistributes large sums from net contributing countries, such as Germany and Britain, towards big farming countries, such as France.

There's the rub. The commission's plans will be fought tooth and nail by countries that benefit from the CAP, especially France. Besides protecting their ill-gotten gains from the EU budget, the French make two other arguments. One is that this is supposed only to be a modest mid-term review of the CAP: the 1999 Berlin summit fixed the CAP budget until 2006. We are willing to discuss radical reform, claim the French, but not until 2006. The second is to point at the United States, for years one of the chief critics of trade-distorting farm protection. Now the Americans have approved a new farm bill that not only vastly expands farm subsidies, but also, against the European trend, links them more closely to production.

The commission's plans will be fought tooth and nail by countries that benefit from the CAP

Besides being an egregious waste of American taxpayers' money, the farm bill is sure to make the Doha round negotiations far harder. It deserves all the opprobrium that has been heaped on it around the world. But to treat it as an excuse to put off CAP reform would be quite wrong. Reform is needed now not just on its own merits and for the Doha round, but also because the EU is due to take in up to ten Central and Eastern European countries in 2004.

Strike now, or forget it

The commission does not want to extend CAP subsidies immediately to these newcomers, for that would bust the budget completely; to their dismay, they are initially to get only one-quarter of the payments granted for existing members, though that is to rise later to match them. Once inside the Union, however, and given that farmers account for 14% of the workforce in the ten (and 20% in Poland alone), the newcomers are sure to become fierce defenders of farm subsidies. It would be disastrous to entrench an even stronger farm lobby than today's without radically reforming the CAP first.

France will not see it like that, of course; and certainly not President Jacques Chirac, a former farm minister with a sentimental attachment to the land. But that need not matter; CAP reform is formally a matter for majority vote in the EU Council of Ministers, even though European summits conventionally operate by consensus. At the Berlin summit in 1999, Mr Chirac alone insisted on watering down farm reforms. The other countries, led by Germany's Gerhard Schröder, weakly gave in. This time round, France must be outvoted.

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Terrorism in Spain

Banning Batasuna

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Should Spain ban ETA's political party? On balance, no

AP

Get article background

THE ETA gunmen who want to carve an independent Basque state out of Spain (and France) have killed hundreds. They keep thousands in fear. One Basque party, Batasuna, is, beyond question, their political wing. So should it be banned?

Most Spaniards think so. A new law making it easier won huge parliamentary support last month. One investigating magistrate, Baltasar Garzon, the pursuer of Chile's Augusto Pinochet, has now taken his own initiative. He argues that Batasuna should pay *euro*24m ($23m) for damage caused by violent members of a Basque-separatist youth movement; and, since it refuses, he has told the banks to freeze its accounts. This could strangle the party rather than kill it at a blow. Again, most Spaniards probably applaud. But is this majority right?

The balance is fine, but, hesitantly, we think not. The very basis of democracy is that all legitimate views, even those of anti-democrats, are entitled to political expression. That principle must be the starting-point of any argument. And, as a preliminary, any decision to overturn it must be a political one. A court ban was in theory possible even before the new law. But, in such a matter, it is not for lawyers to set the law rolling. If the government of Spain thinks it right to ban Batasuna, it should have the courage to do so, and argue its case openly.

Such a case would not be at all difficult to make. In a free polity, as Spain is, why should representatives of an organisation that sets off bombs and murders civilians be allowed to sit as if they were respectable politicians in parliament? But it is not so simple. Batasuna does not repudiate the terrorism its armed friends practise, but neither does it overtly preach it. Its own complicity in the violence has not been proved. The only certainty is that it refuses to denounce the violence, despite evidence that its own electoral fortunes wax when ETA is observing a truce and wane when it is setting off bombs. In 1998, at a time when ETA had declared a truce, the then party (it was reborn last year under its present name) took 18% of the vote in regional elections. ETA began killing again in early 2000—and in elections in May 2001 that figure fell to 10%. Yet Batasuna refuses to denounce the men with guns, while complaining of the alleged “repression and violence” of the Spanish state.

The party's position—winking at terrorism, claiming the respectability of democratic politics—is repugnant. But a ban would be wrong. The British never banned Sinn Fein, even at a time when its IRA comrades were up to their elbows in blood. That made an eventual political settlement easier. Spain's Basques need no guns: they are not oppressed as Northern Ireland's Catholics once were. Far from it: their region is governed by a non-violent separatist coalition which also dreams of independence, and eagerly promotes the (even there, minority) Basque language and culture. But even these non-violent people (who took 43% of the vote in 2001) oppose banning Batasuna: they fear that would mean more violence, not less, while tending to strip the separatist cause itself of legitimacy.

There are other, pragmatic, arguments against a ban. Silencing their political party might persuade more young Basques that the gun is the only weapon; Batasuna anyway would spring up again, under another name; one day ETA will want to talk again, and a front party might help. But the real case against a ban is one of principle. Let the law hammer all who practise violence, and gag attempts to preach it. Hammer Batasuna when it oversteps the line. But not before: terror is not a legitimate argument, but association is not guilt.

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Japan

A dashing disappointment

Jul 11th 2002
From The Economist print edition

Time to abandon any remaining hope in Junichiro Koizumi

Getty

Get article background

IT IS tempting—only natural, indeed—to be cheered by signs of a brightening economic picture in Japan. After all, growth in the first quarter of the year surprised everyone, with a jump of 5.7% at an annual rate. That sets the stage for positive growth this year, bringing to an end Japan's fourth recession in a decade. The Bank of Japan's latest *Tankan* report of business confidence shows that, although pessimists still outnumber optimists among executives, sentiment has leapt by bounds, mainly because overseas demand for cars and electronics is on the rise. What is more, the stockmarket has regained its poise even as American and European markets fret about the rot in their forms of capitalism. Earlier this year, the Nikkei 225 slid alarmingly, threatening to bring down Japan's enfeebled banks, which rely on their equity holdings for capital.

Not so fast. The new shoots of growth are real enough. But without the structural changes to Japan's economy that the prime minister, Junichiro Koizumi, came to office in April last year promising to deliver—a clean-up of the banks' bad loans, privatisation, deregulation and administrative reform—those shoots will shrivel and die. They have, indeed, done so on several occasions before. Nothing in America or Europe matches the rot in the state of Japan. A return to export-led growth, however mild, ought to provide an opportunity to make the difficult choices that will bring efficiency and long-term growth to the economy. Instead, it appears to be the perfect excuse to put choices off.

Two pieces of excuse-making have come in the past week. Ever since he was postal minister in the mid-1990s, Mr Koizumi has said that the postal savings system needs urgently to be broken up. In effect, the post office, with ¥240 trillion ($2 trillion) in assets, is the world's largest bank; there is also an extra ¥120 trillion in its life-insurance system. Not only does the postal savings system undermine private-sector competitors. It also funds a shadow budget that squanders money by smothering almost every hillside and watercourse in concrete, and by building bridges and roads that lead nowhere useful. That is the system's direct hurt to the economy. The indirect hurt is that the money sloshing around the system keeps the old guard of the ruling Liberal Democratic Party (LDP) in business, and the old guard continues to stymie other reforms.

It has now stymied this one. The postal-reform bills that passed the lower house of the Diet on July 9th are a travesty of Mr Koizumi's earlier ambitions. They do not even attempt to think about the distortions caused by the savings and insurance systems. Rather, they focus on mail delivery—and even there, reforms are feeble. Competitors to the post office must set up a daunting minimum of 100,000 post boxes, while the legislation blocks any cuts in the number of state branches.

The second putting-off of hard choices comes with personnel changes at the Financial Services Agency (FSA), the body that is meant to be cleaning up banks' ¥150 trillion of bad loans, but whose ministerial head, Hakuo Yanagisawa, denies there is a crisis. This week the agency's top bureaucrat, Shoji Mori, retired (see article). He preferred to prop up rotten banks—if need be, by rigging the stockmarket—rather than weed them out, and his place had been widely expected to be taken by a man more open to reform. Instead, Mr Mori is being replaced by an ally, close to the LDP's old guard.

Both episodes mark disappointment in Mr Koizumi himself: in a shaking up of the postal system, his

experience was supposed to bring some heft, while the FSA appointments (unusually in Japan) fell to the cabinet office to make. Was it barely more than a year ago that a dashing Mr Koizumi came to power on a wave of popularity, promising “structural reform without sanctuary”? Since then, reform efforts have run into the sands of LDP resistance (the post office), or they have been met with indifference by the prime minister himself (the banks). And since January, when Mr Koizumi cut a seedy political deal to get rid of his popular, if capricious, foreign minister, his ratings have tumbled by half.

Blame the PM

A spent force, then? Certainly, the costs of inaction mount, and trade-offs that are tough enough already get harder to make. One of the biggest is whether to cut taxes to spur growth or to raise taxes and cut spending in order to plug the fiscal hole (see article). Every extra year of spending on public works adds to Japan's government debt, already over 130% of GDP.

Mr Koizumi's fans still argue that the prime minister may be down, but he is not yet out. Even if the public is no longer as impressed as it once was, he is still more popular than his party—which gives him some sway over it, if only by being able to call a general election in which the LDP would undoubtedly be mauled. Mr Koizumi, the fans claim, will still prove to be a mould-breaker.

Yet the party has now become emboldened by Mr Koizumi's pliability. Unless Mr Koizumi changes fast, deciding that compromises have got him nowhere, then it is time to write him off, just as the banks' bad loans should have been written off long ago.

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Afghanistan

A little less bombing, please

Jul 11th 2002
From The Economist print edition

America has won the Afghan war. To win the peace, it may have to let the odd enemy get away

EPA

IN THE post-war chaos of Afghanistan, it is easy to add two and two and come up with five. That is why many commentators have concluded from a pair of incidents—the “friendly fire” accident in which American aircraft killed 50 or so people at a wedding party, and the murder by unknown assailants of one of the new government's vice-presidents—that America is about to lose the peace in Afghanistan. Such a conclusion is premature, to say the least. Yet both incidents show how things could indeed go badly wrong.

Whoever killed Hadji Abdul Qadir, the vice-president, minister of public works and governor of Nangarhar, this was a reminder that, even after America's removal of the Taliban, politics in Afghanistan can still be shaped by the gun. Though Mr Qadir was popular in his home province, he made some enemies, and his death seems certain to spark a succession contest in the east of the country. Such power struggles have rarely been peaceful in Afghanistan. This one, in a region that is a prime producer of opium and its associated revenues, is more than likely to see its portion of violence (see article).

Even if the succession is smooth, the killing of such a senior member of his government, and one of its few top Pushtuns, poses a challenge to the authority of President Hamid Karzai. He has been struggling to establish his authority beyond Kabul, but lacks a loyal army or police force capable of keeping fractious warlords in line. Unwisely, the outside world has not heeded his pleas to expand the mandate of the International Security Assistance Force beyond the capital in Kabul. Nor was this latest murder of a senior politician the first: the tourism and aviation minister was killed last February. Mr Karzai pointed an accusing finger at members of the Tajik-dominated Northern Alliance, America's main allies in the war against the Taliban, but the murder remains unsolved. Failing to identify and punish those who killed Mr Qadir would confirm an impression that in the new Afghanistan tribal and other disputes can still be settled with impunity through violence.

The link between Mr Qadir's murder and America's latest friendly-fire accident is that both reinforce the belief of the majority Pushtun tribe that they have got a raw deal from the post-war settlement. Having formed the backbone of the Taliban, many are now fleeing persecution in the north. In the south and east, they have borne the brunt of American-led military operations against what is left of the Taliban and al-Qaeda forces. The attack on the wedding was only the latest of many such cases of mistaken identity.

Mr Karzai is himself a Pushtun. But, though an accident, the killing by his American mentors of some 50 innocent Pushtuns hardly endears him to an ethnic group that was already sceptical of his ability to defend their interests against the Tajiks. Mr Qadir had been one of the few Pushtun members of the Northern Alliance, but even he was openly critical of the ethnic imbalance in the interim administration that took over from the Taliban. In the eyes of many Pushtuns, the reshaped government that emerged from the recent *loya jirga* did too little to tilt the balance back. They expected Mr Qadir to be their champion in government. And now he is dead.

The danger that seems paramount right now is not that Taliban fighters will storm out of the hills and retake the country. It is the possibility of a return to the 1990s, when the Afghan factions that kicked out the Soviet invaders turned on one another, demolished central authority and created the conditions that

led to the Taliban's rise. For all its squeamishness about “nation building”, America hopes to ward off this danger by helping to create a loyal army and police force. It could doubtless do more to buttress the new government, but all this is the work of years. What the Americans can do right away is change their military tactics. Having won the war against the Taliban, they can afford to concentrate less on tracking down every enemy straggler or al-Qaeda member still in the country, more on avoiding accidents that undermine the government their victory produced.

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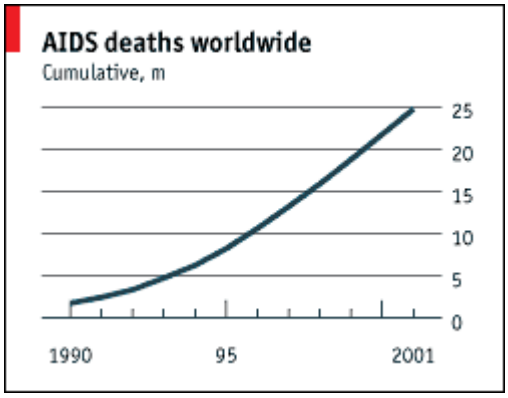
AIDS

The long war

Jul 11th 2002
From The Economist print edition

If you think AIDS is bad in Africa now, wait till it gets a grip on the rest of the world

Get article background



JUST a reminder. Some 40m people are infected with HIV, the AIDS virus. Another 20m have died of it already. Around 3m more will do so over the next 12 months. That is nearly 9,000 a day—three times as many people as died in the terrorist attack on the World Trade Centre last September. Every day, 15,000 more people are infected. Unless things change a lot for the better, almost all of them will die of it, too. And most of those people will be young. AIDS is a disease that takes people in the prime of life, rather than in decrepit old age.

It is much easier to notice, deplore and act against deaths caused by human wickedness than deaths caused by nature. But if all men are created equal, all avoidable deaths should be regarded as equally sad. And AIDS is the one cause of such deaths that is rising, not declining. AIDS kills predominantly in poor countries, compounding the problem. Poor-country governments must do whatever is in their power to save their citizens from this scourge before waving a collecting tin at the rich. But common decency suggests that the rich world should do whatever it can to help. For, despite the availability of drugs that can keep the disease at bay in those who can afford them (or whose governments can), AIDS has not gone away. Indeed, it is getting much worse.

Digging deep

At the moment, the worst affected countries are in Africa. Some places have infection rates that are above 30%, or even 40%, of the adult population—and still rising. Cynics in the West might write Africa off. Are China, India, Indonesia and Russia to be written off as well?

All these countries (two of them the world's most populous nations) are threatened. The Chinese government admits to 1m infections—widely regarded as an underestimate. India admits to 4m. Indonesia's case load is still tiny but, after years of stability, an epidemic is raging through the country's prostitutes. Elsewhere, that has been an early sign of trouble. In Russia, the catalyst is intravenous drug use, rather than prostitution, but the result may be the same. A projection by Imperial College, London, suggests Russia may have 5m people infected with HIV in five years' time, 4m of them suffering the symptoms of AIDS.

The first task for such countries is to own up to the scale of the problem. Too many governments still feel shy about discussing this horror in public. Then, they need to spend wisely the money from the recently created Global Fund—to use it to best effect, and to encourage donors to keep donations coming. As for the rich countries, America can do most. Already, America makes a contribution that, as a proportion of the rich-world total, is roughly in line with its share of its GDP. But as Stephen Lewis, the United Nations' special envoy on AIDS to Africa, pointed out to the recent International AIDS Conference in Barcelona (see article), that is because other countries align their contributions with the American benchmark. If America gave more, the rest would probably follow.

If properly supervised, such extra aid could be well spent. Even something as simple as more condoms would help. Better education, including sex education, is essential, especially for girls, since more women than men die from AIDS. Women also need stronger legal protection against sexual violence. Testing

programmes should be particularly encouraged, as prevention is better than cure. Spending is needed on health-care infrastructure, including clinics, equipment and doctors. Infrastructure to deliver a vaccine also needs to be planned, so that it can be quickly put to use when a vaccine is eventually invented. And poor countries need to copy the example of Brazil, which has made good use of the fact that anti-AIDS drugs can now be bought fairly cheaply outside the rich world, thanks to a liberal interpretation of international treaties on patent law (and also to decent behaviour on the part of many drug companies).

The Global Fund for AIDS, tuberculosis and malaria hopes to raise about $10 billion a year, more than half of it for AIDS. That is a large sum, but an affordable one. Already 3m people a year are dying; without renewed effort, the figure will rise. Surely, a toll so dreadful demands the utmost urgency.

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Letters

Jul 11th 2002
From The Economist print edition

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Corporate governance

SIR – Your leader on governance claims that there is a lack of appropriate candidates for director roles ("Under the board talk", June 15th). In fact, there is an apparent unwillingness by present non-executive directors to let any new ones join the club and spoil the party. This office receives around four inquiries daily, from executives and non-executives seeking board appointments as independent directors.

Recruiting directors properly will in itself help deliver stakeholder value. If an organisation is unwilling to use a proper process to ensure that it hires the best possible directors, then this failure becomes a governance issue. It shows a willingness to accept attendees rather than contributors.

Stephen Cooke
Voices of Experience
London

SIR – Recent developments at Enron, Tyco, ABB and others have created the impression that the quality of corporate governance of public companies is poor, despite a multitude of corporate-governance commissions and recommendations. Legislators, stock exchanges and commissions respond to these concerns by defining ever more structural requirements for boards. The limited value of structural elements can be seen in many boards that have truly independent external directors, and follow all the official rules and recommendations, but still perform poorly in difficult times. Every director knows that the real difference between a good and a bad board is not primarily determined by structural elements but rather by the personalities involved and the way they interact. These "soft issues" are not discussed publicly because they do not easily lend themselves to external evaluation or academic research.

Many directors see the main weakness of their boards in a lack of open and critical discussion. When board members were interviewed after a severe crisis, many had felt that something was wrong before the crisis became apparent. However, when these concerns were expressed, they were ignored by the "better informed" management. The board's "country-club atmosphere", full of unwritten rules, did not encourage critical remarks or discussion. We should try to resist the temptation to over-regulate boards and leave them the freedom and responsibility to become more effective on their own initiative.

Florian Schilling
Managing partner
International board practice
Heidrick & Struggles
Frankfurt

Called to account

SIR – While WorldCom clearly understood the implications that its accounting shenanigans would have for its financial statements, such ramifications seem to have been lost on you ("Another cowboy bites the dust", June 29th). Although it is true that characterising financial outlay as capital expenditure instead of cost does serve to increase reported profits in a year, this action actually decreases cash flow (because of a higher tax burden). Is it time to replace economics with accounting as "the dismal science"?

Ronal Bhagat

New York

Slumming it?

SIR – Your lengthy polemic on Kenya failed to live up to the well-deserved reputation of *The Economist* for informed, incisive prose on international affairs ("The view from the slums", June 29th). The Kenyan government has not "allowed the country's roads and sewers to crumble and rust". Rather, it is the suspension of donor support that continues to place a severe constraint on the public resources available for financing road and sewerage investment. Even so, over Ksh10 billion ($127m) was allocated to physical infrastructure investment in the 2002 national budget, including Ksh8.4 billion ($107m) for roads alone. The budget, incidentally, also contains provisions to protect and legitimise the very small traders that your article made frequent sensationalist references to.

Mac Obare
Kenya Development Forum
London

Arab identity

SIR – Your excellent article on Arab development contained one error ("Self-doomed to failure", July 6th). Clovis Maksoud is not a "respected Egyptian". Mr Maksoud, a former Arab League ambassador to the UN, is Lebanese.

Pierre Habshi
Beirut

Cuban missile crisis

SIR – When Condoleezza Rice declares the Cuban blockade an example of "forestalling certain destructive acts against you by an adversary", she gives an interesting interpretation of the Cuban missile crisis ("Caveat pre-emptor", June 22nd). It was the Russians who "forestalled destructive acts" against themselves, by seeking to counterbalance the American first-strike capability represented by the medium-range Thor missiles based in Turkey. The secret deal between Khrushchev and Kennedy that ended the crisis saw the removal of the American first-strike capability from Turkey, together with the Soviet withdrawal from Cuba.

Alex Klimburg
Shanghai

User-friendly

SIR – You have it backwards about new software (Technology Quarterly, "Buggy whipped", June 22nd). It is not that users "value new features more than reliability" but that we live in hope that new releases will be less buggy. We are all cockeyed optimists in that sense, believing companies would surely know if there were problems, and believing that they wouldn't issue a new release without addressing them. We continue to be amazed at how wrong we can be.

The other aspect is incompatibility. They force us to upgrade by making the programs that handle documents incompatible with older versions of the same software. So if you have not got the latest version, you cannot even read a document prepared by someone who has. Boycotting the software does not solve this problem and they know it.

David Wineberg
New York

Rule 110

SIR – Stephen Wolfram, in his book "A New Kind of Science", demonstrates, in your words, "that a cellular automaton known as Rule 110 can operate as a universal computer" ("The emperor's new theory", June 1st). You rightly call this demonstration a "tour de force". The proof of the conjecture, as Mr Wolfram notes, was due to Matthew Cook, who assisted him. Mr Cook, after heroic efforts, found "the main elements of the proof" in 1994; he and others subsequently revised some of the details.

Allan Gibbard
Michigan

World Cup goals

SIR – You declare that Ronaldo's eight goals in this World Cup were “a feat unequalled by any player since Brazil's Pele in 1970” (“The world this week”, July 6th). Please, give the losing Germans their due: Gerd Müller scored ten goals in 1970.

João Luis Hamburger
São Paulo

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Bush and Big Business

The unlikeliest scourge

Jul 11th 2002 | WASHINGTON, DC
From The Economist print edition

No recent president has been so close to corporate America. Can George Bush possibly bite the hand that has fed him for so long?

THERE he was—America's first president with an MBA, the man who loves to boast about his business background, whose presidential campaign raised unprecedented sums from corporate wallets and whose cabinet is stuffed with chief executives—standing before 700 pinstriped Titans in a New York hotel ballroom, dressing them down. Faith in the integrity of American business leaders was being undermined, George Bush said fiercely, by executives “breaching trust and abusing power”. The business pages of American newspapers “should not read like a scandal sheet.” It was time for “a new ethic of personal responsibility in the business community.” He was going to “end the days of cooking the books, shading the truth and breaking our laws.”

No Republican president has so bull-whipped business since trust-busting Teddy Roosevelt railed against the “malefactors of great wealth” a century ago. And there was more. “Responsible leaders do not collect huge bonus packages when the value of their company dramatically declines. Responsible leaders do not take home tens of millions of dollars as their companies prepare to file for bankruptcy.” As Ralph Nader, erstwhile presidential candidate and America's best-known business-basher, put it, the former compassionate conservative was now the chiding conservative.

Only months ago, the idea that Mr Bush would publicly lambast America's corporate bosses was laughable. As a candidate, borne on the wave of a decade-long economic boom and an unprecedented 18-year bull market, he cashed in on Americans' love affair with corporate success. But things are different now. The stockmarket bubble has burst and, despite signs of economic recovery, Wall Street seems to be sunk in gloom. A string of scandals at some of America's most high-flying firms—including Enron, Xerox, Tyco, Global Crossing and, most recently, WorldCom—has radically changed the public mood. As investors see their portfolios shrink, venerated corporate bosses have been exposed as fraudulent hucksters. Worse, many of the bedrock institutions of American capitalism—accounting rules, oversight bodies, boards of public companies—have been found wanting. Time and again, it appears, auditors and outside directors failed to detect or disclose corporate malfeasance.

As political pressure for reform increases, so too does the heat on Mr Bush. With control of both houses of Congress at stake in November's mid-term elections, Democrats have been quick to pounce. In the past week, Mr Bush's own business background has come under fire (he was investigated by the Securities and Exchange Commission on suspicion of insider trading in 1990, but the case was dropped). So too has Harvey Pitt, Mr Bush's chairman of the SEC. Both Tom Daschle, the top Democrat in the Senate, and John McCain, Mr Bush's Republican challenger, called on Mr Pitt to resign this week, claiming

that he has been too slow to react to the scandals.

Mr Bush's political opponents are also out ahead on reform. This week, the Senate was preparing to pass a Democrat-inspired corporate-reform bill, the brainchild of Paul Sarbanes of Maryland, that promises the most thorough overhaul of American accounting since the 1930s (and is considerably more radical than a bill already passed by the House of Representatives). Mr McCain this week called for even more wide-ranging reform, including requiring companies to record stock options as a business expense, and preventing top corporate bosses selling shares in their firms while they head them.

Not quite like Teddy

Is the businessman's president really prepared to take business on and push hard for reform? Despite the set jaw and aggrieved tone in New York, probably not. Mr Bush may have sounded a little like Teddy Roosevelt, but he showed scant sign of thinking like him. Roosevelt, a Progressive Republican, radically reshaped America's economic landscape—and, in the end, left his party. Most famously, he broke up the “trusts”, the powerful corporate monopolies that dominated late-19th-century America, by bringing 44 antitrust cases in seven years.

Mr Bush, by contrast, thinks the current crisis stems from a few bad-apple chief executives rather than the system as a whole. Hence his focus on tough penalties for corrupt businessmen and his plea for higher ethical standards. The president announced the creation of a “financial-crimes SWAT team” at the Justice Department to root out corporate fraud, and wants to double the maximum prison sentence for financial fraud from five to ten years. But he offered few concrete suggestions for systemic reform: no mention of forcing companies to record stock options as an expense, little mention of changes to strengthen shareholders' rights, not even an endorsement of the Senate corporate-reform bill, though he gave a brief nod to the weaker House version.

This “bad apples” theory is also one that corporate America is keen on. TV news programmes are full of corporate bosses deploring the “shocking” and “unconscionable” behaviour of a few of their peers. Tom Donohue, the boss of the powerful US Chamber of Commerce, this week excoriated the “inexcusable and unethical behaviour” of some of his kind. “Put 'em in jail!” he thundered at a press conference, banging his fist on the table. In the same breath, however, Mr Donohue warned against “over-reaching responses” and vowed to fight all the most radical parts of Mr Sarbanes's bill.

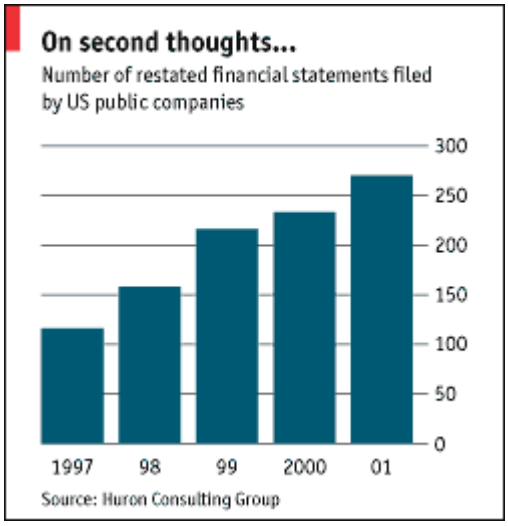
A close look at Mr Bush's team shows clearly why his position and Mr Donohue's are not far apart. Unlike the Reagan crowd, who—despite impressive stock portfolios—stormed into Washington from California in 1980 determined to cut the size of government and beat communism, Mr Bush has surrounded himself with less ideological types, veterans of the corporate establishment.

At the top, four of his cabinet secretaries are former chief executives of large American companies. Vice-President Dick Cheney ran Halliburton, an oil-services firm; Paul O'Neill, the treasury secretary, headed Alcoa, an aluminium giant; Donald Rumsfeld at Defence ran General Instruments; Don Evans, the commerce secretary, ran Tom Brown, an oil and gas company. No president since Eisenhower has had more than one ex-chief executive in the cabinet, and Eisenhower had only two.

Less well known is the infusion of corporate types at lower levels. At the Defence Department, Thomas White, the secretary of the army, was formerly head of the energy-trading arm at Enron; James Roche, secretary of the air force, came from Northrup Grumman; Gordon England, secretary of the navy, was with General Dynamics. Yet more junior ex-corporate staff have come into the administration with them.

Lobbyists have also fared well. Andrew Card, Mr Bush's chief of staff, was once the top Washington lobbyist for the car industry. Mr Pitt of the SEC made his career as a lawyer representing the accounting industry, lobbying hard against any tightening of the

rules. (As a result, Mr Pitt has had to recuse himself from many of the SEC's decisions this year: at least ten of his former clients are currently under SEC investigation.) Two other Bush appointees to the five-member SEC also came from accountancy firms.



Too close for comfort

Business insiders were considered, at least for a while, as a positive asset to government. The White House bragged that they would make it run better. This year's budget, for instance, promised “competitive sourcing”, the “strategic management of human capital” and a “Management Scorecard”. From the famously cumbersome Pentagon to the Treasury Department, efficiency would be improved, the Bush team promised, by men who understood about the bottom line.

Unfortunately, business smarts are now a political liability. Mr White, the army secretary, was the first embarrassment. His assurances that he knew of no wrongdoing made him appear either incompetent or fraudulent. The next, and potentially much more serious, scandal could concern Mr Cheney: the SEC recently began an investigation into possible accounting irregularities at Halliburton when he was chief executive.

Finally, Mr Bush's own business background is coming under embarrassing scrutiny. In 1990, when his father was president, Mr Bush sold 212,000 shares in Harken Energy, an oil company of which he was an outside director. Two months later, the company announced a loss and the shares tumbled. A subsequent SEC investigation revealed that Mr Bush had not disclosed the sale of his stock in the “timely manner” the law required. The president's excuse for not filing the papers was a “mix-up” with his laywers. Though the SEC investigation in 1990 went nowhere, it is clear that (at the very least) Mr Bush failed to keep to the disclosure standards he demands from corporate bosses.

More telling than the business connections of his team is their policy record so far. For all the free-market talk during the campaign, this administration has excelled at forsaking sensible economics in the face of powerful special interests.

Trade policy offers a prime example. Mr Bush, who touts himself as a free-trade president and who pushed for the launch of a new global trade round, has nonetheless been happy to slap on protectionist tariffs. His decision in March to impose tariffs of up to 30% on imported steel was the most outrageous (and certainly something Bill Clinton, for all his faults, never did). He has also put tariffs on softwood lumber, and has tacitly condoned the efforts of Congress to offer more protection to America's dying textile industry.

Then came the farm bill, which two months ago overturned the market-based agricultural reforms that were bravely brought in in the 1990s. The farm bill busts the budget and threatens, by itself, to undermine the prospects for concluding a new global trade round—all in the interests of doling out huge cheques to American agribusiness. Nor did the Bush administration flinch from offering America's airline industry (briefly shut down by government order after September 11th, but flailing long before) a bailout last year. Months after the terrorist attacks, administration officials are still engaged in deciding which airlines should receive government-guaranteed loans.

Although a few free-market purists haunt the White House, too many of the corporate types in the Bush team equate good economic policy with what is good for business. Sometimes the two coincide. Mr Bush's decision to embrace voluntary, rather than mandatory, guidelines for workplace ergonomic standards, for instance, increases employers' flexibility and makes economic sense. So, too, do his relaxations of parts of the Clean Air Act.

But too often this administration's policy seems to be expressly tailored for (and heavily influenced by) business lobbies. Mr Cheney's much-ballyhooed energy plan, prepared last year, appears to have been largely written by the energy industry. Similarly, this year's "economic stimulus package" was less an effective tool of economic policy than a sop to corporate America. Its main provision was a three-year investment-tax break. Even the conservative *Weekly Standard* called the bill "a collection of corporate pork, self-serving subsidies and narrowly focused favours".

Perhaps most telling, the Bush team has taken few goodies away from corporate America. Last year's budget, for instance, demanded a $12 billion cut in corporate welfare. Nothing happened. Instead, government spending—even excluding defence and homeland security—is rising fast. Part of this is, of course, the result of the recession, but for all the high-minded talk about reining in government, Mr Bush's team has presided over an explosion of corporate spending.

Politics comes first

This grubby tale is not unprecedented. Mr Bush's protectionism still pales in comparison with Mr Reagan's—the man who slapped "voluntary export restraints" on cars and machine tools and introduced minimum price floors on semiconductors. For all their Adam Smith ties, the Gipper's aides in the White House were only too happy to help out American farmers and other friends.

Moreover, the blame for the recent sycophancy towards business lies with Congress as much as with the White House. In an election year, with control of Congress in the balance, lawmakers from both parties are keen to spend lavishly, bail out airlines, suck up to steel firms and fatten the wallets of rich farmers. And the motivations of the Bush team, too, have often been crudely political. The steel tariffs were in part an attempt to shore up Republican votes in West Virginia, Ohio and other steel-dominated states. The farm bill was designed to boost Republican chances from Arkansas to South Dakota in the mid-term elections. Both sprang less from corporate prodding than from the political calculations of Karl Rove, Mr Bush's chief political strategist and the most important adviser in the White House.

In fact, when Mr Rove's electoral strategy demands it, corporate America's demands have been ignored. The tax cut that Mr Bush signed in 2001 did not (as businessmen wanted) cut the corporate-tax rate or hand them the other tax breaks they craved. Instead, corporate America was told to wait. Mr Rove wanted to use the tax cut to shore up the conservative base of the Republican Party. Mr Bush was to be painted as Mr Reagan's heir, determined to hand the American people back "their money", rather than as the candidate of big business.

This record suggests that Mr Bush will try to reform business practices only as far as Mr Rove impels him. And the omens are not good. There is unlikely to be pressure for action from the right. As many disgruntled conservative intellectuals are pointing out, the modern conservative movement has gone corporate. Marshall Wittmann, a leading conservative scholar, argues that the anti-government and anti-communist glue that held the conservative movement together has been dissolving. Big corporatism has taken its place. Many former firebrands of the Republican right are now making money as lobbyists. It is a sign of the times that Marc Racicot, the new chairman of the Republican Party, refuses to give up his day job at a law firm with numerous lobbying clients, though he promises not to lobby himself.

Nor is it clear how far Democrats will ride the bandwagon of corporate reforms. Though senior Democrats have turned up the populist rhetoric recently, this is the party Bill Clinton recast as one that was friendly to business. Al Gore's anti-business populism in the 2000 campaign may now sound prophetic, but the party establishment has yet to endorse it (see article). Democratic lawmakers, too, know the determinedly friendly embrace of corporate lobbyists. Joe Lieberman, Mr Gore's running-mate, is well known as a friend of Silicon Valley. Not surprisingly, he has long been a staunch opponent of reforming the treatment of stock options. This week's Senate activity, centred on the Sarbanes bill, may well mark the climax, rather than the start, of the Democrats' reformist zeal.

Most important, there are few signs yet that cleaning up corporate America is an issue that animates the voters. Polls show that Americans have little faith in their business leaders—a recent survey found less trust in corporate America than in the paedophile-shuffling Catholic cardinals—but politicians do not seem to be suffering as a result. Mr Bush's approval ratings have fallen from their sky-highs, but they are still very strong.

The president, therefore—Mr Rove may well say—need do no more than talk tough. This alone will convince ordinary Americans that he is on top of the issue. As the economy rebounds and public outrage

subsides, the clamour for change will quieten. Democratic attacks will fizzle, and far-reaching reform bills will be watered down before they become law. Politically, the gamble makes sense. Unfortunately for American capitalism, a great opportunity will be missed.

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State budgets

Tangled up in red

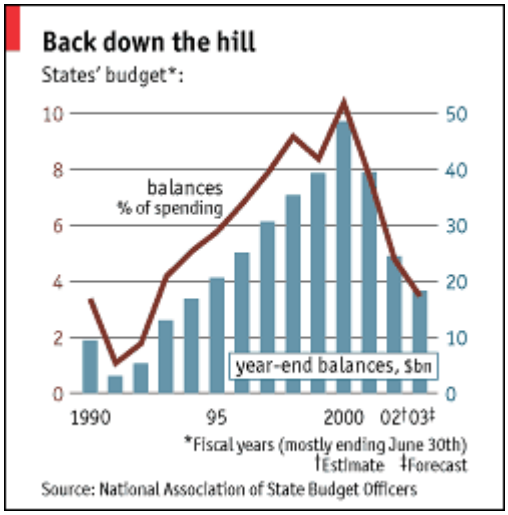
Jul 11th 2002 | WASHINGTON, DC
From The Economist print edition

State budgets are a disaster. And, yes, this does matter

“WE ARE faced with any number of bad choices,” says David Redwine, a lawmaker from North Carolina, of his state's effort to close its dire budget deficit. “It's pretty much pick your poison.”

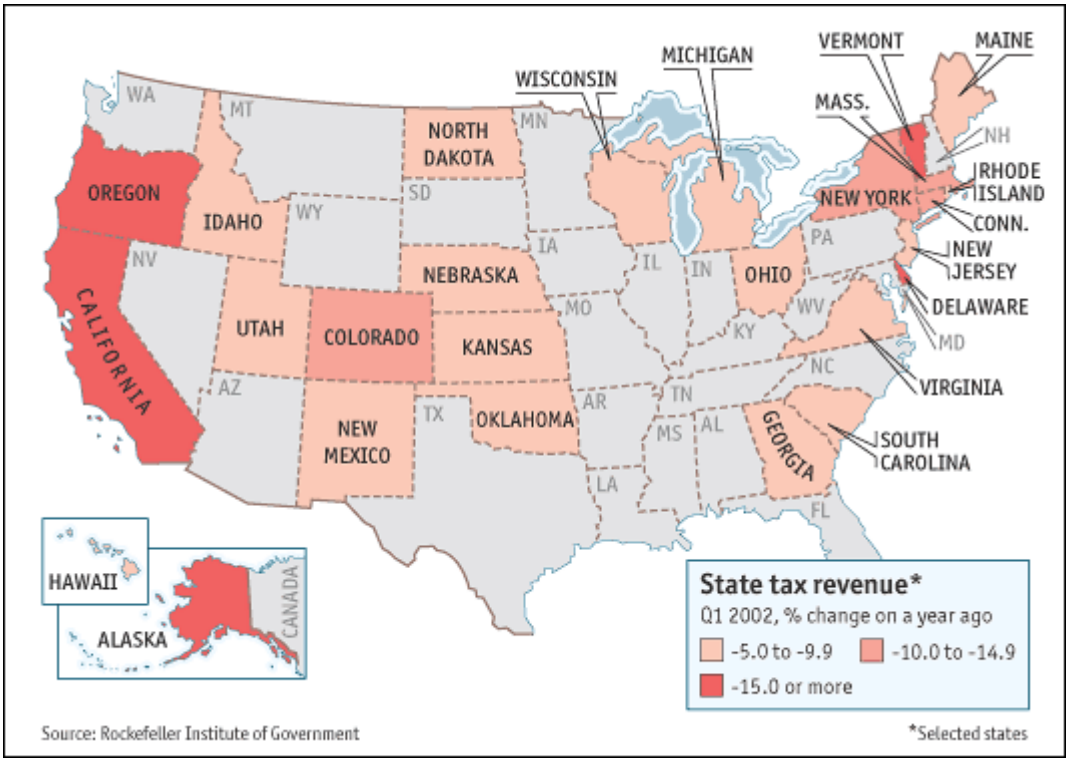
North Carolina is no exception. In New Jersey, the governor threatened to send state troopers to round up local politicians who failed to appear for a special session on the budget. In Kentucky, the state treasurer is asking a judge whether the state can legally operate without a budget (it was one of half a dozen that failed to pass one on time). Tennessee had to send half its state workforce home when it briefly ran out of money. And California faces a budget deficit of $23.6 billion, a staggering 25% of revenue—a deficit which, if it were being run by a country, would send the currency crashing and usher in the International Monetary Fund.

July marks the start of most states' fiscal years and this year (fiscal 2003) will be the second dreadful one in succession. In fiscal 2002, state revenues were 5.6% lower than expected when budgets were adopted, according to the National Association of State Budget Officers (NASBO). This year will be worse. Only days into the new fiscal year, some states are already calling for special legislative sessions because their new budgets—mostly based on revenue forecasts made in April—look unrealistic.



That raises a troubling question: are these woes largely cyclical, attributable to last year's slowdown in the economy? Or are they structural, to do with the way states raise and spend money? The answer matters not only to the states themselves, whose spending accounts for around 5% of American's gross national product. It also affects national policy. States are responsible for swathes of America's public services, including education, public health, welfare and a good deal of spending on infrastructure and the police.

The best reason for thinking the current problem is cyclical is simply that it has happened before. State budgets were hammered in the recessions of the early 1980s and the early 1990s. Scott Pattison, NASBO's executive director, argues that state budgets lag behind the national economy by 12-18 months, which is why their main problem at the moment is that revenue is falling at a time of modest recovery.



The first three months of this year were the worst quarter in living memory. Total tax revenue fell almost 8%, compared with the first three months of 2001, with some big states seeing falls of 15% or more (see map). The real problem was worse. Some states raised taxes in fiscal 2002. If you adjust for this, and for inflation, the underlying revenue fall was 9.5%, according to the Rockefeller Institute of Government at the State University of New York in Albany. And if you look just at April—the month when states process most income-tax returns, and which serves as a harbinger for the rest of the year—personal income-tax collection fell by almost a quarter.

Even if all this were mainly the result of the national slowdown, that would not necessarily be good news, at least in the short run. Since the 12-18 month lag has some way to run, Mr Pattison reckons fiscal 2003 will be even worse than 2002: revenues will fall further, requiring far more painful spending cuts next year.

Still, after that one might expect an upturn, tracking the business cycle. States have become slightly more dependent recently on income taxes, which account for 18% of total revenue. They depend particularly on taxing the incomes of their richest inhabitants. Those revenues, which have always been volatile, have become even more so thanks to the growing importance of stock options, capital gains and other non-wage income. If the economy recovers, states might benefit disproportionately in the recovery, as they have suffered disproportionately in the downturn.

Certainly, the states themselves appear to take this optimistic view, at least to judge by their attempts to balance their budgets (as all but Vermont are constitutionally required to do: deficit financing is banned). Because it is election year, and 36 governors are up for re-election, politicians have been more than usually reluctant to make unpopular spending cuts or tax hikes. Instead, they have resorted to all manner of jiggery-pokery.

The most egregious example comes from Wisconsin, supposedly a paragon of good government. It has taken almost all its share of the money paid out to states by tobacco companies, used it to back a bond issue, and then used the bond to balance the budget. The tobacco settlement was supposed to be spread over 25 years, so this amounts to spending a quarter of a century's income at one fell swoop.

This would be dubious at the best of times. But what if the underlying justification—that states merely have to get through a couple of bad years before the good times return—is wrong?

Pause for thought

The states are having one of their worst years on record as a result of one of the mildest recessions America has ever suffered. That suggests there may well be structural factors affecting states in addition

to the cyclical ones. Two present themselves: first, the abnormal behaviour by states during the boom years of the 1990s; and, second, the way they raise and spend money.

The Rockefeller Institute's Don Boyd argues that the states faced an almost ideal set of circumstances during the 1990s. Personal incomes were rising so fast that states could cut taxes and still boost revenues. At the same time, the cost of two of the main spending programmes was tamed. Medicaid (health care for the poor) is the second-largest item of state spending after education. In the mid-1990s, its costs stabilised as a result of introducing “managed care” into the health system, and because the poor were doing relatively well, cutting enrolment. Meanwhile, the cost of welfare, their third-biggest expense, also dropped, thanks to strict new rules.

This combination of higher revenues, tax cuts and abating costs was extremely unusual, but states reacted to it as if it were a permanent condition. They increased real spending by 28% per person during the 1990s, committing themselves to a range of new or expanded programmes. This was a classic example of counting your chickens before they are hatched.

States increased real spending by 28% per person during the 1990s

These circumstances will not soon recur. Medicaid costs are already rising. The first effects of the managed-care revolution are wearing off, and “medical inflation”—mainly the cost of new drugs—is rising. The Congressional Budget Office forecasts that Medicaid costs will rise by 9% a year for the rest of the decade.

Receipts from income taxes may grow faster than the economy as a whole. But they are extremely unlikely to rise by the double-digit rates of the 1990s. To give an extreme example: California is one of the states most dependent on income from capital gains. The state's legislative analyst's office reckons that, after the dotcom bubble burst, revenue based on capital gains and stock options fell an astonishing 62% last year. Even if the markets rebound, says Mr Boyd, it would take at least five years of 20% annual growth in capital-gains income for California to get back to the level of revenue it had in 2000. Unless another bubble of similar size appears, states are not going to see a return to 1990s-style income-tax gains for a long time.

The sales tax—the other main component of revenue—is almost as shaky. American consumers will surely not spend an ever-rising share of their income (it is already very high), and, if savings rise, sales-tax receipts may fall. Worse, state sales taxes are out of date. They are based almost entirely on goods, at a time when more and more consumption is switching to services. A moratorium on taxing transactions made over the Internet does not help, and a top priority of the governors is to try and overturn it.

The conclusion is disturbing. State budgets are unlikely to return to health soon. In the short term, that will cast a shadow over the re-election chances of some governors this year and many budget negotiations next year. But the more profound impact will be felt in the long term. If states have to adjust to permanently tighter fiscal conditions, what will that do to the many public services they now supply?

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Tobacco taxes

Smokes on the water

Jul 11th 2002
From The Economist print edition

Do you know the way to the Unkechaug Indian Nation?

THE cost of living in New York has always been high. Earlier this month the cost of killing yourself went up, too, when Mayor Mike Bloomberg, desperate to raise cash, walloped the city's smokers with a hefty rise in tobacco taxes. A packet of cigarettes from a news-stand in the Big Apple will set you back around $7. Of that, $1.50 goes to the state, and an additional $1.50 now goes to the city.

Relief for New York's impecunious nicotine junkies is, however, at hand. They need only wheeze their way over to the Original Poospatuck Smoke Shop and Trading Post, near Mastic, Long Island. It's one of four discount tobacco shops within the tiny Sovereign Territory of the Unkechaug Indian Nation. The Unkechaugs have a legal right to buy and sell cigarettes tax-free. That's why you can pick up a packet of gaspers at the Poospatuck Smoke Shop for between $2 and $3.50.

For years the state of New York has struggled to collect taxes on cigarettes sold on Indian territory. Legal challenges to the concepts of Indian sovereignty and tax immunity, mounted by the likes of the New York Association of Convenience Stores, have been successfully fended off. Considering the volume of trade involved, their concern is understandable. A recent article in the *New York Times* estimates that, with some 85 Indian-owned tobacco outlets across New York, the loss to the state (quite apart from the loss to the city) is probably in the order of $24m a month.

Harry Wallace, chief of the Unkechaug nation and owner of the Poospatuck Smoke Shop, remains sanguine. “The sale of tax-free tobacco has provided us with an independent economy where none existed,” he says. This has had a positive effect throughout the 225-strong Unkechaug community. An organic-coffee firm has been established; a new school which teaches Indian history to children has been built; traditional and contemporary art is being promoted; the renovation of ceremonial grounds is under way.

“This is not just about cigarettes,” Mr Wallace says thoughtfully. “This is about the lawful exercise of sovereignty and about empowerment through the generation of revenue.” Make that *two* cartons of Lucky Strikes, then.

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Race and policing

Inspector Morse strikes again

Jul 11th 2002
From The Economist print edition

A nasty beating in Los Angeles stirs unhappy memories

Get article background

AP

You have the right to remain silent

IN MARCH 1991 an amateur video of four police officers beating a black motorist called Rodney King helped to provoke one of the worst riots in American history, leaving 54 people dead and 2,000 injured and causing more than $1 billion in damage. On July 6th 2002 another amateur video, once again showing the arrest of a black motorist, raised similar doubts about police racism in what Californians call “the Southland”.

The video shows a white police officer, Jeremy Morse, hoisting a handcuffed black teenager to his feet and smashing his head on a car trunk. He then punches him in the face, while several other officers, some black and some white, stand behind him. Eventually one of them intervenes.

Although it was not as prolonged and sinister as the King beating, the incident involved considerably less provocation. Mr King was a fearsomely strong man, allegedly high on drugs, who tried to flee from the police in a high-speed car chase and then attacked them when they tried to arrest him (hardly things that justify what happened to him, but all factors that had a great impact on the white jury that initially acquitted the LAPD officers who beat him). Donovan Jackson, the victim in this case, was a slender 16-year-old, a special-education student with no arrest record. The problem that provoked the clash was a routine traffic stop (the licence plate on the Jackson family car had expired).

Mitchell Crooks, the tourist who took the videotape, was not shocked: “I just thought it was standard procedure; I thought it was normal in Los Angeles.” But his handiwork nevertheless caused a storm when it was broadcast on local television. Mr Morse's case has not been helped by the fact that another man has since come forward claiming to have been handcuffed and beaten by him.

Dozens of angry protestors descended on Inglewood City Hall calling for Mr Morse to be sacked. Maxine Waters, the local congresswoman, sent a letter to the attorney general, John Ashcroft, demanding an investigation into the altercation. Mr Jackson's lawyers went to the federal courthouse in downtown Los Angeles to file a lawsuit, calling it a “seven-figure case”. Four separate law-enforcement agencies duly opened investigations.

Is there any chance that this incident will provoke more than just a flurry of investigations and lawsuits? The likelihood of civil unrest is lessened by the fact that the incident took place in Inglewood, an independent city that nestles between four freeways, rather than in big, bad Los Angeles proper. Mr Morse works for Inglewood's police department, rather than the LAPD. Inglewood's mayor is black, as are two of its four council members.

With luck, the local political establishment will be able to solve this problem before anger turns to violence again. But a new tape, this time of police in Oklahoma clobbering another black man, will ensure that the issue of police brutality continues to promote controversy—and rightly so.

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About sponsorship

The Republicans in Illinois

Ryan v Ryan

Jul 11th 2002 | CHICAGO
From The Economist print edition

The Republicans in Illinois have stopped being boring—and electable

WITH sharks circling and blood in the water, is it any surprise that no one wants to jump into the pool? That is the predicament facing the Illinois Republican Party less than four months before election day. Plagued by scandals and riven by internal feuds, the once boringly efficient party, which has controlled the governorship for 29 of the past 33 years, now seems unable to do the simplest things in politics—such as recruiting a new chairman.

The latest crisis began with the resignation on June 28th of chairman Lee Daniels, who remains the party's leader in the state House of Representatives. In that latter capacity he faces allegations that his legislative staff did campaign work on state time during the 2000 election. The job of investigating those charges would normally fall to the state's attorney-general, Jim Ryan, but he is the current Republican candidate for governor. He handed Mr Daniels's case to federal prosecutors, who are already investigating George Ryan, the current governor (and no relation), over a nasty scandal dating back to his days when he was secretary of state, involving his office licensing illegal truckers.

Mr Daniels denies any wrongdoing. He decided to resign as party chairman in an attempt to avoid further damage to the Republican ticket in November (Jim Ryan would probably have pushed him if he hadn't jumped). Yet his departure has not brought order to the party.

So far, Jim Ryan has asked three people to become the party's boss: a former governor, a former businessman and an incumbent congressman. They all said no. The Republican State Central Committee did no better. All its members could agree at a meeting on July 8th was to appoint their own vice-chairman, Dallas Ingemunson, as an interim chief. Mr Ingemunson promptly asked for the resignations of the entire state party staff; when the executive director refused, he was fired.

All this is overshadowed by the federal investigation into Governor Ryan's people. Operation Safe Road is looking into claims that the secretary of state's office in the 1990s accepted bribes to issue driving permits: several of the fraudulent truckers were involved in horrific crashes. The three-year-old investigation was reinvigorated last year by Patrick Fitzgerald, an energetic federal prosecutor, who made his name in New York tackling terrorism and organised crime. In the past few months, a succession of Governor Ryan's aides and allies have been indicted.

In the past few months, a succession of Governor Ryan's aides and allies have been indicted

The governor faces no charges, but his protestations of innocence and ignorance have been met with mounting disbelief. This week Jim Ryan's frustration boiled over, and he called on his namesake to explain his role in the scandal or step down. Governor Ryan replied that he had no intention of leaving before January.

Politics may also have been at work in *Ryan v Ryan*. The governor, who, among other things, has visited Fidel Castro and ordered a moratorium on the death penalty, has become increasingly liberal in his views. The other Mr Ryan is a more conservative figure, and he needs to rally the party faithful who detest his namesake.

The big winner from all this is Rod Blagojevich, a congressman who is the Democratic candidate for governor. On the day the two Ryans were trading barbs, he picked up an endorsement from the Illinois Education Association, a teachers' group, which has hitherto usually backed Republicans. Polls give him a fair lead over Jim Ryan. But Mr Blagojevich also has to convince voters that he would run a cleaner state. Republicans are already slyly pointing out that his father-in-law is a big ward boss in Chicago.

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A mess in Arkansas

E-nailed

Jul 11th 2002 | LITTLE ROCK
From The Economist print edition

The governor's electronic guru has sharp teeth

AP

Huckabee, virtually famous

THE governor of Arkansas, Mike Huckabee, recently flew to a computer-industry conference in Washington, DC, to receive an award for being an innovator in e-government. Curiously, at about the same time, other politicians back in Arkansas were grilling the guru who designed much of this fabled e-government, trying to find out how bad it really is. They have summoned him back for another inquisition next week.

Randall Bradford moved to Arkansas last year from Texas to supervise the state government's technology, especially the Arkansas Administrative Statewide Information System (AASIS), a high-tech accounting system. Last month Mr Huckabee unexpectedly fired Mr Bradford from his $150,000-a-year job, for allegedly being untruthful and unco-operative. Since then Mr Bradford has been a thorn in the Republican governor's side, producing e-mails from the governor's staff urging him not to work with Democratic legislators, and making it clear that the $52m AASIS is not quite the award-winner it seemed.

Arkansas's claim to fame in e-government circles is that it was the first state to pull together all its 148 state agencies electronically. Last July AASIS brought more than 35,000 state employees on to an integrated system designed by a German firm, SAP, which was one of the sponsors of the award the governor received (and also nominated him for it).

The system was originally supposed to cost only $22m. But the cost has doubled, and a mixture of over-runs, payroll foul-ups and delays in payments to state suppliers has irritated the workers struggling to master the new system. Mr Bradford adds that AASIS, which includes sensitive information such as tax returns, is “100% vulnerable” to hackers.

Mr Bradford claims that the governor's people tried to bury these failures. He was required to submit his reports to the governor from a private e-mail address (supposedly so that people could not recover them under freedom-of-information acts). Mr Bradford, who has been summoned to appear before the legislature again on July 19th, is threatening to sue both the state and Mr Huckabee over his firing.

The state is still squabbling with the federal Department of Health and Human Services about whether it should repay $9.4m in federal money inappropriately used for AASIS. And now the Internal Revenue Service has fined the state $164,000 because it took too long to provide the agency with $8.1m withheld from state workers' pay packets. State officials blame the amount of time they had to spend manually compiling the information for the missed deadline.

The governor says he is not afraid, and claims the whole thing is a Democratic plot. But, with Arkansas's budget spilling red ink, the idea that $50m has disappeared into a faulty computer system is not likely to make voters love him.

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About sponsorship

American sports

Balls, pills and dollars

Jul 11th 2002 | NEW YORK
From The Economist print edition

It must be summer: baseball players are thinking about going on strike

BASEBALLING life is, alas, getting back to normal after a brief, heady post-September 11th respite. In the difficult months following last year's terrorist attacks, baseball put aside internal feuds, introduced stirring renditions of “God Bless America” towards the end of each game and became an emotional tether for a frayed nation. It was all too good to last.

There has been growing concern about steroid use: where exactly have all those recent homers come from? Now the ninth shutdown since 1972 looms.

As the annual all-star game—in which the players are selected by fans—got under way earlier this week in Milwaukee, the players (average salary: $2.4m) sent their own elected team to a hotel in Chicago. After several hours of discussion, the delegation emerged to hint strongly that they were considering a strike, just before the crucial autumn playoffs. This would cost the players themselves a fortune, the owners even more, and leave fans seething. In anticipation of the players' move, Bud Selig, Commissioner of Major League Baseball and (not coincidentally) owner of the team hosting the all-star game, said his colleagues were willing to tolerate a strike extending not only until the end of this season, but also into next year.

A strike would cost the players themselves a fortune, the owners even more, and leave fans seething

Behind the present confrontation is the controversial assertion by team owners that the game—supposedly the epitome of American fair play—has become mired in greed and inequity. High-profile teams, they feel, attract large audiences and rich TV-contracts, which lets them buy the best players, which lets them have the best teams, which lets them get all the money.

As many as eight of the 30 professional teams face financial collapse, Mr Selig says. So the owners are pushing for a revenue-sharing scheme, a “luxury tax” on teams with high payrolls, tighter restraints on foreign players' contracts, and the termination of at least two franchises. In effect, they, like the managers of any business, would prefer the existing talent to be available to fewer bidders who would have substantial incentive to bid less.

To which the players offer three compelling rejoinders. The first is that the numbers given by owners of baseball teams are no more trustworthy than the numbers given by other American companies. Even the owners themselves would undoubtedly revise their estimates if you offered to buy their baseball operations. Tax allowances for the depreciation of players mean that reported losses may actually mask highly profitable operations. Owners go to great lengths to separate their team from their other, more obviously profitable, businesses.

The Boston Red Sox, for example, claim an operating loss of $11m, yet the team sold in February for a record-breaking $700m—largely, according to *Forbes* magazine, which publishes an annual valuation of the major-league teams, because of an affiliated cable network. Similarly, *Forbes* notes that the Los Angeles Dodgers lost $30m last year, but added $200m in value to Fox Sports Net, which, along with the Dodgers, is owned by Rupert Murdoch. All told, *Forbes* reckons that 25 out of the 30 major-league teams appreciated in value last year. This suggests an industry in decent financial health.

The players' second argument is that the strict recruitment regulations which owners have called for would not be tolerated in any other area of American business. This issue has a long history, dating back to a bizarre 1922 ruling by the Supreme Court which exempted the sport from federal antitrust laws on the grounds that it did not constitute interstate commerce—notwithstanding the fact that almost every

game is between opponents based in different states and games are broadcast throughout the country.

Lastly, it is by no means clear that the skewed payrolls in baseball have produced predictable results. Witness the different fortunes of New York's two teams, the Yankees and the Mets. The Yankees have the highest payroll in the major league, are forever acquiring expensive new stars and have been a regular presence in the World Series. The Mets also maintain a stratospheric payroll. Yet they have routinely failed their supporters. Among the teams they currently trail are the Montreal Expos, which have a minuscule television contract and tiny payroll.

All of which makes fans long for a time when baseball was less about money and pills and more about sport. If there was ever a man who embodied these good, old-fashioned values it was Ted Williams, a remarkable hitter who took his eye off the ball only to serve in the second world war and, later, in the Korean War, where he proved himself a heroic fighter pilot. Williams died on July 5th. In what may be seen as a sad reflection of the times, his body was reportedly frozen by a cryonics lab as part of a plan (devised by his son) to sell his DNA. A more disturbing thought is the preserved star's reaction should he awaken and see the state of his game.

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Competitive eating

A man who can stomach New York

Jul 11th 2002 | CONEY ISLAND
From The Economist print edition

It takes guts to eat 50½ of Nathan's famous hot dogs

IN THE annals of sport, seldom has a victory been so decisive, or fellow competitors so crushed and demoralised. At high noon, on a sweltering July 4th, a young Japanese man, weighing in at a mere 112 pounds, out-ate the best, not to mention the biggest, that the rest of the world had to offer, scoffing down an astonishing 50½ slimy hot dogs in just 12 minutes. Takeru "The Tsunami" Kobayashi gained 17lbs (7.7 kilos) in the process and narrowly avoided what, in this kind of competition, is referred to politely as a "Roman incident".

AP

The Tsunami flanked by Roman incidents waiting to happen

The contest goes back to the 1916 founding of a small hot-dog stand on Surf Avenue, near the Coney Island boardwalk, by one Nathan Handwerker. The stand still operates under Nathan's name, and the competition has taken place every year except 1941 (as a protest against the impending war) and 1971 (as a protest against the summer of love). Because a single Nathan's hot dog is more than enough for the average consumer, and four of them an invitation to disaster, the contest was always intriguing. But in the past two years, with the remarkable entry of Mr Kobayashi, who had set the previous record of 50 last year, it has become the talk of the town.

Mr Kobayashi was carried to his seat atop a large hot-dog float to thunderous applause from more than 1,000 onlookers. Curtis Sliwa, a raving radio talk-show host, invoked Pearl Harbour in a nasty attempt to incite the crowd against a Japanese man entering a quintessentially American competition on the day the nation celebrates its independence; but he was booed off the stage. As in so many other areas of life, New York loves a winner, regardless of his home town, and Mr Kobayashi, without a doubt, was a winner. In second place, Eric "Badlands" Booker, a 410-pound New York subway conductor, could barely swallow his 26th hot-dog.

Unlike any of the 19 other competitors, whose style rarely deviated from the conventional method of starting at one end and finishing at the other, Mr Kobayashi brought a sense of industrial efficiency to the task. Placing a cup of water on each side, he dunked the bun with his left hand and crammed it in his mouth, while with his right hand he dunked the hot-dog and brought it midway up his chest. Then, with both hands, he broke the hot-dog in half and, with one section in each hand, used the sausage as a plunger to force down the bun as he chewed.

For his victory, Mr Kobayashi received a return plane ticket and the coveted mustard-yellow champion's belt. According to organisers, he has earned $150,000 since winning the previous contest, including $25,000 for a winning appearance at the “Glutton Bowl”, in which he consumed 18lbs of cows' brains.

This year, for the first time, wagers were taken on whether Mr Kobayashi could maintain his dominance. The odds were staggering: 1-to-2 that he would eat at least 20 more hot dogs than his closest competitor. Punters laid down more than $30,000, though the Antigua-based firm running the pool, BetWWTS.com, will not disclose how the money was placed. But anyone in the know would have been unlikely to bet against The Tsunami.

After the contest, his belly grossly distended, Mr Kobayashi was asked what next. Hinting at reserves yet to be tested, he replied: “Ice cream”.

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Lexington

A prophet without honour?

Jul 11th 2002
From The Economist print edition

The Democrats' former champion had a point about corporate America. Will it do him any good?

AL GORE won dismal reviews for his decision to reinvent himself, in the middle of the last presidential campaign, as a people-versus-the-powerful populist. Didn't Mr Gore realise, his critics argued, that he was squandering his greatest asset, the fact that he had been vice-president during the longest boom in American history? Didn't he realise that a man who inherited his father's Senate seat wasn't a very convincing champion of the oppressed? And didn't he understand that all he needed to do to win was to present himself as Clinton without the sleaze?

Some of these charges may still ring true, but the statistics have never confirmed the theory that Mr Gore's populism was suicidal. After all, he won more votes than Bill Clinton ever managed (51m compared with 47m). And remember that his speech at the Democratic National Convention, in which he first revealed his new religion to the public at large, put him ahead of Mr Bush in the opinion polls for at least a month.

Whatever the merits of running as a populist during a boom, Mr Gore's campaign is now looking more far-sighted by the day. Even the briefest reading of the press cuttings produces some choice quotations. Mr Gore gave warning that his rival was being bankrolled by “a new generation of special-interest power-brokers who would like nothing better than a pliant president who would bend public policy to suit their purposes and profits”; that these special interests were determined to “pry open more loopholes in the tax code”; and that “when powerful interests try to take advantage of the American people, it's often other businesses that are hurt in the process.” The people who would benefit from Mr Gore reining in the corrupt moguls would be “the small- and medium-sized companies that are playing by the rules and earning profits the old-fashioned way.”

American history has alternated between eras of laisser-faire and eras of government restraint. The gilded age gave way to the progressive era. The Roaring Twenties gave way to the New Deal. Now, once again, there are burgeoning corporate scandals and a tumbling stockmarket. It is possible that Mr Gore was one of the first politicians to see another such turning point. Yet even if the current fracas proves to be merely a temporary adjustment, Mr Gore still looks prescient. He argued that the country needed somebody in Washington who was willing to hold corporate America accountable for its misdeeds. Now even George Bush (MBA) is swotting up on his Teddy Roosevelt and threatening errant chief executives with a visit to the woodshed.

You might imagine that the Democrats would be falling over each other to praise their prophetic candidate—that the airwaves would be crackling with the sound of loyal senators claiming that, if only the Supreme Court had sided with Mr Gore rather than Mr Bush, the corporate scandals that are engulfing America could have been averted. You would be wrong. Mr Gore's only recent appearance in the headlines concerned his somewhat churlish admission that he wished that he had relied a little less on consultants during the campaign.

The silence of the Dems

Why are Democrats so reluctant to praise their former champion? Many are still nervous about populism.

They worry about reviving their party's reputation for business-bashing, a reputation that Mr Clinton spent a decade expunging. And they think that Mr Gore's brand of populism is exactly the sort that the party needs to avoid: a populism of the heart rather than the head, of grand rhetoric rather than concrete proposals, of sabre rattling rather than scalpel precision. You can search his campaign speeches in vain for ideas about accounting reform and outside directors—and that is certainly not because of any aversion on Mr Gore's part to tedious detail.

The other reason for the silence is an intense power struggle within the Democratic Party. Many of the party's biggest names are quietly positioning themselves for a run for the White House in 2004. People who see themselves as potential presidents, such as Tom Daschle, the leader of the Senate, and Dick Gephardt, the minority leader of the House, can hardly be expected to trumpet Mr Gore's achievements as a fortune-teller. John Edwards, a photogenic senator from North Carolina, and Russ Feingold, an inveterate campaign-finance reformer, are both busy developing their own brands of populism.

Disillusionment with Mr Gore is not confined to the party's peerage. Many Democratic operatives are about as keen on another Gore candidacy as Sony is on renewing its contract with Michael Jackson. They point out that the real problem in 2000 was always the messenger rather than the message. Mr Gore seems to be capable of only two modes of behaviour: the stiff and charmless, and the outright bizarre (remember his decision to paint his face orange during the first presidential debate, or his gorilla-like attempt to crowd Mr Bush off the stage during the third debate?). A prescient Al Gore is still Al Gore.

Many Democratic operatives are about as keen on another Gore candidacy as Sony is on renewing its contract with Michael Jackson

Yet strategic silence may not be enough to save the Democrats from Mr Gore. One inspiration for him might be another much ridiculed vice-president who blew one election but stubbornly came back to win another. Richard Nixon long ago proved that deeply unattractive politicians can overcome both the doubts of their colleagues and the sneers of the punditocracy to bounce back from defeat.

Mr Gore left the 2000 campaign with important advantages: astronomical name-recognition; a network of fundraisers; and a bitter sense that the election was stolen. Now he can add the fact that he warned America against putting a corporate dupe in Washington. The party barons may not like it. Many party operatives may even dread it. But the unlovable Mr Gore is still in a stronger position than any of his rivals. Each corporate scandal increases the likelihood that the 2004 election will be a rematch of 2000—and even, perhaps, that Mr Gore may win it.

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Correction

Jul 11th 2002
From The Economist print edition

In Lexington ("The McAuliffe effect", June 29th) we said that Terry McAuliffe came up with the idea of renting out the Lincoln bedroom. This was incorrect. Our apologies to Mr McAuliffe.

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Reform in Mexico

Where energy is sacred

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From The Economist print edition

Magnum

Loosening the state's grip on energy is vital for Mexico's development and for President Fox's government. The prospects are not reassuring

AT A prominent intersection in Mexico city's business district stands the Fuente de Petroleo, a monument to the nationalisation of the oil industry in 1938. In authentic socialist-realist style, giant granite men stripped to the waist, led by a bare-breasted mother-earth figure, grapple with oil derricks. In the former Soviet-block countries, such statues were the first victims of the revolutions of 1989. Mexico's very different one-party rule ended two years ago, with the election of President Vicente Fox. But the Fuente de Petroleo is being spruced up, with new spotlights to bathe it in the national colours.

The monument is cherished because it embodies the pivotal place that oil nationalisation played in forging Mexico's nation state. State ownership of all oil and gas resources is still enshrined in the constitution, as is the state generation, transmission and distribution of electricity. But as economic growth has boosted the demand for energy, the state's stranglehold over its supply has become a huge obstacle to Mexico's development. Governments lack the cash to invest in energy, but foreign and private investment has to squeeze its way through loopholes. For the past two decades, every Mexican president has acknowledged this problem.

So it is with Mr Fox. If he is to achieve his ambitious pledge of annual economic growth of 7%, energy reform is vital. Take electricity. Officials reckon that the country's generating capacity is just 44 gigawatts. Taking the international average ratio of energy consumption to economic output, if Mexico is to achieve the average income level of the OECD countries it would need to generate some 140 GW. Similarly, imports of gas are soaring, while Pemex, the state oil and gas monopoly, is hampered by being the government's cash cow, providing 37% of federal government revenues. And that is only the legal part: a former boss of Pemex, now in the United States, faces charges that he siphoned off $170m to finance the presidential campaign of the formerly ruling Institutional Revolutionary Party (PRI).

Mr Fox once said he favoured privatising Pemex, but backed down in the face of an outcry. In his campaign, he promised only to introduce reforms to allow private investment in energy. Now his government is at last making its proposals public. They have turned out to be rather timid—unsurprisingly, perhaps, given that Mr Fox lacks a simple majority in Congress, let alone the two-thirds majority needed to change the constitution.

In oil and gas, the government is pinning its hopes on a new legal formula called “multiple service contracts”. Their chief virtue is that they do not require constitutional change. They do not grant investing firms any share in production; instead, the idea is that profits come from meeting output goals

set by Pemex. The details are to be spelt out in secret appendices, yet to be negotiated.

Pemex hopes to use these contracts to attract $8.8 billion of private investment to develop the Burgos basin, a big gas field in the Gulf of Mexico. But the service contracts are “too complicated and subject to too much political risk” to attract large-scale investment, says Rogelio Ramirez de la O, an economic consultant. Already, opponents have claimed that they amount to “partial privatisation”, and are thus unconstitutional. They could yet be struck down by Mexico's newly independent courts.

No bolts from the blue

The same uncertainty clouds electricity reform. Since 1992, private investment in electricity generation has been legal. But the price of electricity is still set by the Federal Electricity Commission (CFE), the main state firm, and less than 4% of electricity is privately generated. To boost this, Ernesto Martens, the energy secretary, proposes giving private generators more “flexibility” in selling direct to customers, allowing them to compete on price with the CFE. Mr Martens claims that he can do this within the constitution. Others have their doubts. In April, the Supreme Court threw out as unconstitutional another government proposal for electricity reform.

Then there is Congress. Last year, the government saw its radical tax-reform bill mauled by lawmakers. This time, ministers are consulting before drawing up a bill. Mr Fox claimed this week that there was all-party agreement to “study” the electricity question. Roberto Madrazo, the new leader of the PRI (still the largest party in the legislature), has said that he is willing to work with Mr Fox. But reaching a deal on electricity reform will be hard. The PRI is divided on the issue, and has little interest in giving the president a political triumph before a congressional election in 2003.

Given the lack of a legislative majority, Mr Fox's ministers say they must settle for incremental changes. But investors have been burned by half-baked energy reforms elsewhere, from China to Brazil. They may not put much money into Mexican energy until regulations are clearer. For their part, supporters of Mr Fox, who last month marked the second anniversary of his election victory, had hoped for much more from what promised to be a government of national transformation. Energy reform is set to be Mr Fox's biggest test. Perhaps it will take a few more power cuts for him to be successful.

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Politics in Brazil

Pacting with the enemy

Jul 11th 2002 | SAO PAULO
From The Economist print edition

The opposition and the IMF

Get article background

WITH polls saying that the left-wing opposition leader might succeed in his fourth try at the presidency, investors panic, fearing the country will default on its huge debts. That was South Korea in 1997 and is now the situation in Brazil. What saved South Korea was a pre-election deal with the IMF, which provided a $57 billion bailout in return for all the main candidates—including the veteran opposition leader, now president, Kim Dae Jung—pledging to honour its terms. Might a similar deal be in the works in Brazil?

In Brazil's case, this would involve Luiz Inacio Lula da Silva, the left-winger who leads the polls, and all the other main candidates in October's election, agreeing to stick to responsible macro-economic policies. In public, the IMF and Brazil's outgoing president, Fernando Henrique Cardoso, talk down the idea. But Pedro Malan, the finance minister, said this week that such a pact should not be ruled out. “The signals are coming from the opposition parties themselves,” he said. Others backing the idea include Enrique Iglesias, of the Inter-American Development Bank, and Vicente Fox, Mexico's president, who is said to have raised the matter with the candidates during a visit to Brazil this month. But would Mr da Silva, like Mr Kim, renounce his anti-IMF rhetoric and sign?

Mr da Silva has sounded cool towards the idea, saying that international accords are a matter for Mr Cardoso alone until he steps down on December 31st. But his economic adviser, Guido Mantega, said he would consider such an accord if market panic over Brazil's debt worsened.

Not so long ago Mr da Silva's Workers' Party (PT) was organising anti-IMF marches and talking of “renegotiating” both Brazil's IMF agreement and its other debts. But recently the party has moved towards the centre. It now promises to honour all bonds and other contracts, and says it will follow (slightly looser) inflation targets. It also says it would stick to the target, agreed with the IMF, of a fiscal surplus (before interest payments) of 3.75% of GDP until public debt is stabilised. This is no small promise, given how little flexibility Brazil's government has over spending (almost all goes on wages, pensions, debt payments and mandatory transfers to local government). The one bone of contention concerns demands for independence for the Central Bank, though Mr Mantega says that a PT government might consider this after appointing some new directors.

Such is Mr da Silva's grip over his party that he runs little risk of an internal rebellion over any pact with the IMF, reckons Fernando Abrucio, a political scientist at Sao Paulo's Catholic University. But even if he did sign, this might not calm investors unless Ciro Gomes, an unpredictable soft-left presidential contender, followed suit. This week, new polls showed support for Mr da Silva slipping slightly, while Mr Gomes, boosted by recent television propaganda slots, has risen to joint second place with Jose Serra, Mr Cardoso's candidate. Mr Gomes rejects a pact, and has unnerved investors by opposing inflation targets and talking of a “voluntary” swap of Brazil's short-term debt for long-term bonds. Compared with him, Mr da Silva is beginning to sound like a man they, and the IMF, can do business with.

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The Galapagos Islands

Troubled waters

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Can people and iguanas mix?

THE oil spill was small, and the diesel was dispersed before it reached the shores of Isabela, the largest of the Galapagos Islands. But the incident last week highlighted the mounting threat to the unique environment of the islands that helped to inspire Charles Darwin's theory of evolution. In January 2001, a much larger spill from a tanker carrying fuel for tourist boats also appeared to have been contained, with only a fraction of the oil reaching land. However, a recent study found that the numbers of marine iguanas on Santa Fe island slumped from 25,000 to 10,000 after the accident.

The islands, which are part of Ecuador, are undergoing rapid population and economic growth. Over the past decade, the population has doubled, to 18,500. Tourism and fishing are driving this migration. In 2000, says Fundacion Natura, an environmental group, workers in tourism on the islands earned on average $3,708, and fishermen $4,900. On the mainland, by contrast, many workers earned only the minimum wage, then about $1,000.

Though the government is mulling new regulations that would set limits on the islands' economy, and on future migration, these may be less strict than environmentalists want. With tourism booming (almost 80,000 visited last year), operators want permission for bigger boats. Officials have also agreed to a pilot scheme for long-line fishing (to prove that it is not desirable, they insist). In an initial test, 62% of the catch was accidental, including sharks, sea turtles and manta rays.

So far, the Galapagos has kept 95% of the species it had in the mid-19th century, compared with just 50% in Hawaii. It has done so partly by involving the local population. But how long can that continue? “It's becoming ever harder to strike a balance between people who want a pristine nature reserve and those who want aggressive economic development,'' says Fernando Espinoza, the director of the Charles Darwin Foundation on the islands.

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Colombia's conflicts

The battle of Medellin

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A paramilitary takeover of the cities

ONE evening last month, Fabian Alberto Hoyos, a 12-year-old boy, climbed on to the roof of his home in a Medellin suburb, armed with a handful of water-filled plastic bags to throw at his cousins. When he climbed down again, he was clutching the side of his head, a bullet in his brain. He died hours later, an accidental victim of a war between right-wing paramilitaries and left-wing guerrillas for control of the working-class neighbourhoods on the hillsides around Colombia's third city. In this war, say residents, their rooftops have become firing posts, and gunmen aim at anything that moves.

AP

Friendly neighbourhood murderer

The fighting between Colombia's rival illegal armies was once confined to remote rural areas. It has recently reached the cities. Last year, the right-wing paramilitaries of the United Self-Defence Forces of Colombia (AUC) expelled the guerrillas from Barrancabermeja, an oil city that was long a left-wing stronghold. Now they are battling block by block for Medellin, a bustling industrial city of 2m. The AUC claims to control around 80% of the city. Others put the figure closer to 50%, but do not dispute that the AUC's influence is growing.

So is the butcher's bill in Medellin. In the first six months of this year, the city saw 13 killings a day, the worst toll in five years. The violence sometimes takes the form of full-scale battles. In May, nine people, four of them children, died when the army fought for eight hours with guerrillas in the west of the city.

The AUC is infamous for slaughtering peasants it suspects of sympathising with the guerrillas. One reason for its move into the cities is that its guerrilla enemies have drawn it in. But another is its appetite for political power.

AUC units have sought popular support by casting themselves as community-minded commandos. “We make sure that government resources are well spent, that there's no graft, and that people can work. We're fighting for the people's rights,” says “Piolin” a gang leader who is now an AUC commander in north-eastern Medellin. He says he has formed “pacts” with local businesses to generate jobs. Bus drivers, for example, must pay $1.50 to local youths to wash their vehicles at posts where the AUC has tapped water pipes.

The AUC began supplying rifles and radios to “Piolin” three years ago, in return, he says, for promises not

to sell drugs or kill civilians. But those caught stealing in his territory are executed, as are strangers suspected of helping the guerrillas.

Their conquest of Medellin's violent slums represents a return to one of the AUC's roots. In the 1980s, when Pablo Escobar and his rivals ran much of the world's cocaine trade from the city, legions of unemployed youths found work as hired killers in the private armies of drug lords. Some of these gangs fused into the AUC. Others joined guerrilla militias.

The AUC's efforts to build an urban base come as it seeks inclusion in any peace talks organised by Alvaro Uribe, who will succeed Andres Pastrana as Colombia's president next month. Unlike Mr Pastrana, Mr Uribe does not rule out talking to the AUC.

The security forces devote far more effort to battling the guerrillas than the AUC, with whom some officers collude. But the government can no more afford to lose control of cities to the AUC than it can to the guerrillas. What is lacking, argues Luis Fernando Quijano, a former guerrilla who now runs an NGO, is a bigger effort to tackle the social problems that drive Medellin's youth into the ranks of the illegal armies. With the AUC claiming that it will have the entire city under its control within two years, time is running out.

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Panama's foreign policy

Which China card?

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A game of trade and aid

COMPARED with the other two dozen or so mini-states that recognise Taiwan, Panama—with its vital canal linking Atlantic and Pacific—is a diplomatic colossus. Or so Taiwan thinks. In return for such gestures as sponsoring Taiwan's forlorn efforts to re-enter the UN, Panama has received $450m in investment from Taiwanese firms in the past five years, and generous aid. But mainland China's commercial presence in Panama is now growing fast. Will diplomacy follow trade?

Panama's appetite for closer ties with China was whetted by the return to the mainland of Hong Kong, which had banks and shipping lines already in the isthmus. Following the 1997 handover, China became the third-largest user of the canal, after the United States and Japan, and now accounts for 20% of the cargo entering the Colon Free Zone, a huge trading entrepot. A Chinese shipping line has joined the board of the Panama Canal Authority, the agency that oversees the waterway.

In 1996 Panama's government awarded a contract to modernise and manage the ports at each end of the canal to Hutchison Whampoa, a Hong Kong-based conglomerate, which has spent more than $120m so far. China's trade representative in Panama reckons his country now has $200m tied up there, and Hutchison Whampoa has recently promised to invest $240m more.

Inevitably, China is now trying to use its commercial heft to change Panama's diplomatic loyalties, and hopes the six other Central American countries will follow suit. China's trade representative argues that Chinese companies will hesitate to invest in Panama without diplomatic protection (though such qualms have not stopped Taiwanese firms from pouring money into China). A local business group, headed by Oyden Ortega, a former foreign minister, is lobbying for the mainland. “Panama was blind, not knowing the importance of China,” he says.

Officials say that Panama has no plans to switch recognition. And China's case may have been weakened by a row over Hutchison's concession. After the company witheld payments, in May Panama agreed to waive $22m in rent and cut its future fees. In fact, Panama's shrewd calculation may be that it benefits from being wooed by both Chinas. And after celebrating the handover of the canal from the United States in 1999, it does not want to be bossed around by another big power.

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Afghanistan

Murder in a “safe” city

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EPA

Repairing the damage to the new government

HAJI ABDUL QADIR did not have much time to enjoy his new job. As he drove from his office in Kabul on July 6th, Mr Qadir, a vice-president of Afghanistan and minister of public works, was sprayed with bullets and died on the spot. Two gunmen drove away under the watch of ten security guards. The guards have been arrested, as have two men driving a car similar to the one that left the scene. The search for the killers continues, but so far there is little to indicate who ordered the murder, and why. What is clear, however, is that the killing of Mr Qadir, an important figure in Afghan politics, is a serious blow to the fledgling government of President Hamid Karzai.

Mr Qadir was not short of enemies. He was a member of a conservative resistance group led by Gulbuddin Hikmatyar during the Soviet occupation, and at first welcomed Osama bin Laden to Afghanistan when the world's now most wanted man was expelled from Sudan. He became governor of the eastern province of Nangarhar in the early 1990s, but turned against the Taliban after failing to strike a deal when they came to power. He had to flee, and resumed his job as governor at the end of last year after the Taliban were toppled by the American-led coalition.

But he was popular. Huge crowds attended his funeral (pictured). His enemies were to be found among rivals envious of his wealth and influence. He was recently involved in a struggle against Haji Zaman, a gang leader, for control of territory around Jalalabad, the main town in Nangarhar. Mr Zaman was the loser and fled to Pakistan. His followers have no love for the governor. Local rivalries have also centred on drugs. Mr Qadir is believed to have benefited from the lucrative opium trade: Nangarhar is one of the main poppy-growing regions in Afghanistan. His position during recent government attempts to eradicate this year's crop has not been particularly helpful.

Mr Qadir, though belonging to the Pushtun majority that ruled Afghanistan for generations, had strong ties with the powerful Northern Alliance which fought the Taliban to the end. He was one of the few influential Pushtuns in the Tajik-led alliance. Nevertheless, he was seen as a defender of Pushtun interests and publicly criticised what he considered to be the excessive Tajik influence in liberated Afghanistan. During the Bonn negotiations that led to the creation of the six-month interim administration in December, he walked out to protest against what he saw as a Tajik hijacking of power.

Many Pushtuns were hoping that the *loya jirga*, the grand council that nominated a new government in June, would produce a rebalancing of the cabinet's ethnic composition. Tajiks, however, retained their influence, keeping the ministries of defence and foreign affairs, while the former king, a Pushtun, came

under pressure to withdraw from the presidential race.

The vice-president's death is likely to reinforce the Pushtuns' perception that they have nothing to expect from the central government. Pushtuns have been persecuted in the north of the country, where they are a minority, and many have fled the region. In their traditional eastern and southern strongholds, they have been the accidental victims of the fighting between the coalition forces and remnants of the Taliban and al-Qaeda. In January, about 20 civilians died when American special forces stormed a village in Oruzgan. Last week, in the same province, 48 civilians were reported to have been killed and more than 100 wounded during an American-led operation that went wrong. In Paktia, Pushtuns have been complaining about repeated searches.

The growing disenchantment of the Pushtuns only adds to the problems of President Karzai, who has been struggling to expand central authority over an insecure country divided by local rivalries. The government not only lacks the muscle to keep local commanders and their private armies in check, but cannot even protect its own officials. In February, the minister of aviation and tourism was killed by what first seemed to be an angry mob. Mr Karzai then accused members of the Northern Alliance of killing him, but no arrest has been made. Even the powerful Tajiks are not safe: in April, Mohammed Fahim, the defence minister, escaped an assassination attempt in Jalalabad.

Mr Karzai has tried to coax powerful local commanders into supporting the central authority by offering them government jobs in Kabul. Mr Qadir's murder shows that he cannot offer them security. The fact that he was killed in Kabul is a reminder that the gun is feared even in a city considered one of the safest places in Afghanistan, thanks to the presence of the International Security Assistance Force, and where the central government is supposed to be in control. Those tempted by the prospect of a job there may now prefer to remain in their fiefs, where they can be protected by their own men.

In spite of Mr Karzai's repeated calls for protection to be provided for other parts of Afghanistan, friendly foreign countries have been willing only to provide peacekeepers for Kabul and instructors to help the government train a national army and police. After Mr Qadir's death, some American politicians have renewed calls for the United States to broaden its involvement beyond the military campaign against Taliban and al-Qaeda fugitives, most of whom are anyway now thought to have crossed into Pakistan.

According to George Bush, the training of an Afghan force remains the best way to make the country secure. Home-grown security, however, is unlikely to become effective in the near future, and such security will depend on creating a sense of national loyalty in the ranks of the Afghan recruits. This is by no means a foregone conclusion in a country that has been plagued by warring factions for the past decade. Hardly a comforting thought for Mr Karzai as he seeks to put new life into his bereaved administration.

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Indonesia

A direct insult

Jul 11th 2002 | JAKARTA
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After 57 years, can't voters be trusted to make a sensible choice?

Get article background

AP

"Democracy" of the street

AS THINGS stand, Indonesian voters could elect their president directly for the first time in 2004. They could, but it is not clear that they will. The principle of a direct election was enshrined in the constitution last year, but President Megawati Sukarnoputri said recently that she thinks her people may not be ready yet for this simple democratic act. Miss Megawati's father, Sukarno, declared independence 57 years ago. How much time do you need for a country to mature? The question will be mulled over in August by the People's Consultative Assembly, or MPR, the supreme authority on the matter.

Instead of two rounds of voting to produce a winning candidate, Miss Megawati's party has proposed one round only. If no one received more than 50% of the vote, the MPR would decide the outcome. There would be the political barter of the past, and the likelihood of a weak president. Many Indonesians are fed up and say they will not vote at all in 2004, either for a president or in the parliamentary election due then. Four years of rowdy democracy that sometimes moved into the streets have not done much to improve the lot of ordinary Indonesians, many of whom see signs of a return to authoritarianism.

Miss Megawati's stance has bemused many. In 1999, Indonesia's indirect system of electing the president cost her the race. Opinion polls showed she would have won a direct election convincingly. She became president only last year, replacing Abdurrahman Wahid, who had been installed as a result of horse trading and was later thrown out. But 2004 will not be 1999 revisited. Sukarno's daughter did not inherit his speechmaking talent and might pay for this deficiency in a televised campaign debate.

Her party, the Indonesian Democratic Party-Struggle, came first in the 1999 parliamentary election. But Miss Megawati's closeness to the army has unnerved many. It is still full of would-be reformists anxious to make their mark after years in the cold. But it has also attracted wheeler-dealers who have seen a chance to gain legitimacy and join the ranks of Indonesia's political elite. This wealthy and ill-defined oligarchy, sometimes referred to by the Javanese word *priyayi*, crosses party lines and has in effect ruled Indonesia since independence. But none of the big parties does well on internal party democracy. Most have a charismatic leader, who dominates the party. Ironically, Golkar, the political vehicle of the Suharto regime, does slightly better than the others in this respect. Its leader, Akbar Tandjung, the parliamentary speaker, is at least seen as a pluralist who listens to all views, although the corruption charges he now faces have all but ruined his chances of winning the presidency in 2004.

In September, the House of Representatives will start to debate new legislation that will govern the conduct of the 2004 parliamentary election. All but six of the existing parties will be debarred from running. Critics say the provisions are open to government abuse. Supporters say it is sensible to avoid the chaos of 1999, when 48 parties fielded candidates. The important thing may be that not all Indonesians are so fed up that they have abandoned discussion of the future of democracy.

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India and Pakistan

A change of mood over Kashmir

Jul 11th 2002 | DELHI
From The Economist print edition

What the peacemakers can expect

Get article background

THE American-British caravan of top officials that has been trying to inspire peace talks between the nuclear powers of India and Pakistan is on the move again. Jack Straw, the British foreign secretary, is due to visit the two countries at the end of next week, quickly followed by Colin Powell, America's secretary of state, and next month by Richard Armitage, the deputy secretary of state. Their aim will be to try to lower tensions between the two countries that have had some 1m troops mobilised on their borders for months. Pakistan has to be persuaded to do more to stop terrorists infiltrating into Indian-administered Kashmir, while India has to start to normalise relations with Pakistan and to deal with what Mr Straw has described as the “human-rights deficit” in Kashmir.

The visitors will find the mood in Delhi has stiffened since their caravan last trundled through in May and June. Indian officials say infiltration picked up sharply at the end of June, after a lull, proving, they argue, that Pervez Musharraf, Pakistan's president, has no intention of carrying out pledges he made to Mr Straw and Mr Armitage to stop infiltration “permanently”.

Yashwant Sinha, India's new foreign minister, said a week ago that infiltration was back to levels seen before Mr Musharraf made what was regarded as a peacemaking speech on May 27th. That may have exaggerated the trend; but India is accumulating evidence of infiltration, and the continued existence of terrorist camps near the border, so that it can turn down any requests by visitors for more friendly steps towards Pakistan. It does not want to make any gestures until it sees firm evidence of a change on the border. Without that, the threat of war remains.

India's reactions in the coming weeks may be conditioned by a re-emergence of its diplomats' decades-old prickliness about how their country is treated by the United States. Relations improved during the four years that Jaswant Singh was India's foreign minister, paving the way for America's support for India over Kashmir. But Mr Singh was succeeded by Mr Sinha on July 1st, and the sensitivities have begun to reappear in remarks made this week by India's new top diplomat, Kanwal Sibal. Mr Sibal was previously ambassador in Paris but, possibly more significantly, he was deputy ambassador in Washington at the beginning of the 1990s when relations with America were far from close.

Mr Sibal said on July 8th that America was intentionally giving Mr Musharraf “a lot of room to play with ambiguities on terrorism” so that he had “an alibi” when terrorist attacks took place in Kashmir. American priorities in the fight against terrorism were “not quite in phase” with India's because the United States was less concerned about stopping terrorism in Kashmir than elsewhere. Mr Sibal also condemned the American and British governments' decision to advise their nationals to leave India at the height of the recent India-Pakistan confrontation as a “political act” aimed at pressing India to back off from a possible war with Pakistan.

It is not yet clear whether all this marks a change in the foreign ministry's approach to relations with the United States. If it does, it will be offset by a more corroborative approach by Brajesh Misra, the prime minister's national security adviser. Mr Sinha will be aware that members of Parliament are likely to want him to explain what India has gained from its support for America's international campaign against terrorism, when that campaign is apparently failing to stop Pakistan's support for terrorism in Kashmir.

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Philippines

Americans are going home

Jul 11th 2002 | MANILA
From The Economist print edition

The terrorists who got away

THE United States has begun withdrawing the soldiers it sent to the southern Philippines to prosecute its war on terrorism. What have they achieved? Not a lot. More than 1,000 American troops arrived to assist the Philippine armed forces in their mission to eradicate the Abu Sayyaf, a band of armed Filipino Muslims which once had links with Osama bin Laden. Members of the Abu Sayyaf, although weakened by a series of skirmishes, are still at large in their usual haunts, the mountains and jungles of the south-west.

Because many Filipinos object to the return of troops from the former colonial power, American forces have not been allowed to do any fighting, except in self-defence. Their six-month-long mission has been to train and advise Filipino troops, and help with surveillance, equipment, engineering and logistics. Since the Americans arrived, the Philippine armed forces say they have reduced the strength of the Abu Sayyaf from hundreds to dozens. But the Abu Sayyaf leadership is still largely intact. The United States has offered $5m for the capture of five leading figures in the Abu Sayyaf. The Filipinos believe that they have killed one of the five, but they have yet to find his body.

The United States regards the Abu Sayyaf as terrorists, although its main activity is kidnapping for ransom. America's secondary objective was to help rescue three hostages, two of them Americans. In the course of a rescue operation, two hostages, including one of the Americans, were shot dead. The other American was wounded. A few days later, armed men in the region abducted four Indonesian seamen, although Filipino officers deny that the kidnappers belonged to the Abu Sayyaf. One of the Indonesians escaped.

Most of the American forces are due to be withdrawn by the end of July. There are plans for some to remain, to supervise engineering work and prepare for future training. The United States is to provide another $10m in military aid. American instructors have spent much of their time in the country teaching Filipino helicopter pilots how to use equipment that will allow them to fly at night, and teaching Filipino soldiers how to shoot straight. The Philippine armed forces believe they are now in better shape to finish the task of wiping out the Abu Sayyaf.

The American military presence has been a popular success, at least in the Philippines. There have been calls among Christians living in the predominantly Muslim south-west for the American forces to stay, and even take part in the fighting. President Gloria Arroyo apparently feels she can ignore nationalists who argue that the deployment of American troops compromises Philippine independence. The most prominent exponent of this nationalist sentiment is her vice-president, Teofisto Guingona. Mrs Arroyo showed no qualms in accepting Mr Guingona's resignation from his concurrent post of foreign minister. The more important matter for George Bush is whether the American public will be impressed by the partial success of his soldiers.

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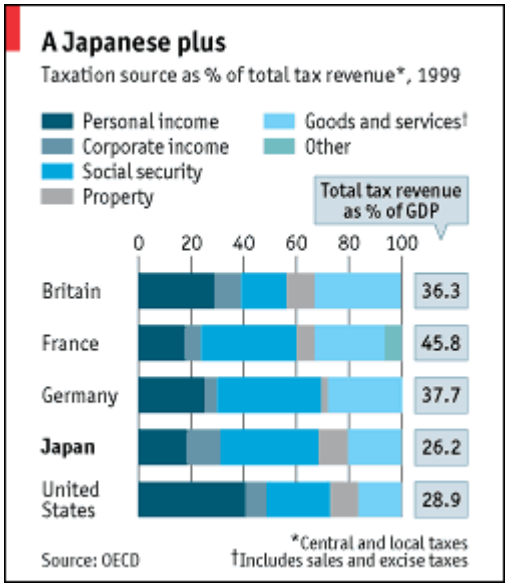
Japan

Taxing problems

Jul 11th 2002 | TOKYO
From The Economist print edition

Koizumi goes into battle again



MOST Japanese have long given up waiting for Junichiro Koizumi to achieve anything bold. On July 9th, parliament made a mockery of yet another of the prime minister's cherished causes, by passing a version of his postal-reform plans that fell far short of encouraging private competition. The mighty post office has resisted a necessary shake-up.

But the compromises and failures have not stopped Mr Koizumi and his team from churning out other reform ideas, while billing each new proposal as another sweeping change. The prime minister's latest scheme for revamping the economy, unveiled as part of a broader economic plan last month, is tax reform.

Mr Koizumi hopes to have detailed proposals ready for parliament by the end of this year. But first he must resolve disputes between the tax committee of his Liberal Democratic Party (LDP), which wants to grant new tax breaks for corporate backers, and the finance ministry, which is keen to shore up revenues in the face of rising debt and ratings downgrades. Mr Koizumi has braced himself for these battles by proposing to do a little to meet the demands of each advisory group.

He does want to grant more tax breaks to Japanese businesses, especially the precious few that invest a lot and make a good profit. At 3.4% of GDP, corporate taxes yield revenues that are close to the OECD average. But because many Japanese companies report little or no profit, the government is getting its take from imposing high taxation rates on a relatively small number of successful firms.

Heizo Takenaka, Mr Koizumi's economy minister, reckons that cuts in tax rates for such firms would lower revenues by up to ¥1.6 trillion ($13.5 billion). Given Japan's public-debt worries, the government must offset this somehow, but despite Mr Koizumi's push to rein in public works, the prospect for filling the gap with spending cuts are “limited”, the minister says. The plan calls for the cuts to be offset by higher taxes on unprofitable companies and households.

Some 70% of Japanese companies, mostly small firms, at present pay no tax. Although technically unprofitable, many firms shield their income by means of generous loopholes. Mr Koizumi aims to tax such things as rents, wages and other expenses. This would eliminate many loopholes, stress economic activity over profits, and generally put a degree of pressure on inefficient companies.

Personal income taxes in Japan, at 4.8% of GDP, are less than half the OECD average (the government gets relatively more revenue from taxes raised to provide social security services). Although Japan's top tax rates are stiff, lower-income households fare relatively well. Mr Koizumi would like to bring down the thresholds for the lower tax brackets. He would also like to overhaul inheritance taxes, which keep savings trapped in the housing sector by discouraging families from selling.

Mr Koizumi's supporters liken these efforts to those of Margaret Thatcher and Ronald Reagan, on the ground that the tax changes will boost productivity. Though such comparisons exaggerate the scope of the plan, the prime minister's proposals would on the whole promote more efficiency. Allowing breaks on investment might not be terribly clever, given that Japanese managers tend to over-invest and ignore profitability. But reducing the burden on vibrant firms, while making life tougher on the zombies, is

nevertheless a step in the right direction. Or it would be, if he actually does it. If he cannot defeat his opponents in the LDP on other issues, can Mr Koizumi really take on working-class families and small firms?

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China

Sex of a cultural sort in Shanghai

Jul 11th 2002 | SHANGHAI
From The Economist print edition

Party games before there was a party line

THE bars and night-clubs of Shanghai are full of prostitutes. Hundreds of shops in the city openly display toys and other devices that are, to put it mildly, adult. Callers to a radio phone-in programme have been known to discuss orgasms. Yet for all the city's freewheeling airs these days, the Communist officials who run it are still remarkably coy. A privately run museum of pre-Communist sexual art and artefacts had to move its premises because it was forbidden to display the word “sex” on the street.

To be fair to Shanghai's bureaucrats, the Museum of Ancient Sexual Culture is not a place for those who are easily shocked. It is an adults-only establishment, though exceptions are sometimes made for education-minded children accompanied by their parents. The aim of it is to show that despite China's reputation as a sexually conservative if not downright repressive nation, the Chinese people have a long history of enjoying sex for its own sake. The more than 1,000 exhibits range from centuries-old dildos (including a double headed one designed for lesbian couples), to no-holds-barred erotic art used by mothers in imperial times to teach their bride-to-be daughters the duties of the bedroom. It is a display that cultural commissars in much more conservative Beijing would ban in an instant.

Until May last year, the museum was near Shanghai's main shopping strip, Nanjing Road. But it was not visible from the street and only those in the know were likely to find it. The authorities refused to allow the curator, Liu Dalin, to display a sign bearing the name of the museum. The visitors were often foreigners who had read about the museum in guidebooks published abroad. In the three years since he opened the museum, Mr Liu has not made much headway in promoting the “natural, healthy attitude toward sex” that he says Chinese couples badly need (the divorce rate is soaring). China is “a long way from being sexually open,” he laments.

Mr Liu has at least found a way around the Shanghai government's prudery. Although he has moved the museum to a quieter street, it is now in a building with large glass doors that allow its name to be seen clearly from the outside. The problem is that he has to find a way of financing the venture. He has monthly bills amounting to thousands of dollars. But he is reluctant to lower the admission price, equivalent to more than $3.50 (a lot by Chinese standards) for fear of attracting too much attention from the wrong sort of people. “We don't want ordinary people,” says an assistant. “We want cultured visitors.” Ticket sales remain depressed.

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Algeria's violence

The horrors of war aren't over yet

Jul 11th 2002
From The Economist print edition

AP

An independence-day bomb recalls Algeria's unfinished civil war

Get article background

EVEN by Algeria's gruesome standards, the bomb that last week killed 38 people—shoppers at a busy weekend market in Larba, a small town near Algiers—was particularly distressing. The attack, blamed on Islamic militants, came on July 5th, as Algerians marked the 40th anniversary of their independence from France. Although their country has been tearing itself apart for a decade, pride in the struggle for freedom was one of the few things that Algerians could agree on.

The country's strife has diminished in intensity, fading from the international headlines. But it is far from over. Some 800 people have already been killed this year. A few days before the explosion in Larba, 13 passengers on a bus were machinegunned in an Algiers suburb. Since then, 14 more people have been killed.

The violence has become so endemic that the world pays scant attention to yet another bunch of Algerians being killed. Western governments long ago stopped their exhortations, half-hearted at the best of times, to the Algerian authorities to resolve their country's crisis by allowing democratic change. Eight years of deadly civil war had been set off by the army interrupting an election to prevent an Islamist party from winning. Now, although Algeria holds elections with all the trappings of a democracy, the country remains a thinly-veiled military dictatorship.

Even that thin veil may be drooping as signs appear of a renewal of the struggle for power, in this case between President Abdelaziz Bouteflika and one or other of the factions in the powerful intelligence and military establishment. An unnamed “authorised source” in the normally tight-lipped defence ministry recently told a local newspaper that in backing Mr Bouteflika's accession to office in 1999, the army had picked the “least bad” of the presidential candidates. In particular, he criticised Mr Bouteflika for discouraging Algerian civilians from mobilising alongside the army to defeat terrorism.

The army chief of staff subsequently called the press together in order to make conciliatory noises. But an expected announcement of changes in the military hierarchy failed to materialise on independence day. The swipes at Mr Bouteflika, it is thought, may have been occasioned by a dispute over who should be promoted into, and who should be retired out of, the charmed circle of military power brokers.

As the generals bicker, Algeria sinks deeper into crisis. The Berber-speaking region of Kabylia has been in a state of civil disobedience for over a year, with the Kabyles calling for an end to the government's repressive practices. The disturbances are not confined to Kabylia. Throughout the country, people are rioting, armed with a long list of grievances that range from corruption to unemployment to water shortages.

The Algerian army, meanwhile, has been trying to salvage its reputation at a court in Paris. Khaled Nezzar, the regime's strongman when the 1991-92 election was cancelled, is suing a young dissident officer, Habib Souaidia, for defamation. Speaking on French television, Mr Souaidia claimed that “the generals killed thousands of people.” His book, “La Sale Guerre” (The dirty war), published in France, alleges that soldiers dressed as rebels massacred civilians (in a bid to turn hearts and minds against the Islamist rebels) and that the security forces tortured many Islamist prisoners to death.

Rewriting history

The trial has turned into a debate over the army's decision to abort the election. General Nezzar's witnesses argued that the army had saved the country from falling into the hands of a barbarian horde. But a dissident intelligence officer, Muhammad Samraoui, was one of the witnesses who gave the game away by telling the court: “We established a list of the most dangerous people and demanded their arrest. But in vain: they were needed [to be free] to create terrorist groups. Instead we arrested others right, left and centre. We were trying to radicalise the movement.”

A verdict is expected on September 27th. But the French prosecutor has already requested that, in the interests of free expression, no penalty should be handed down to Mr Souaidia. “It is not”, she said, “the court's business to write history.”

The generals are unlikely to be perturbed. In the post-September 11th world, they have made new friends. Mr Bouteflika has received a warm message of congratulation on his country's independence anniversary from George Bush, in which Mr Bush describes Algeria as America's ally in the war against terrorism.

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Palestinian leadership

Arafat's fight for survival

Jul 11th 2002 | EAST JERUSALEM
From The Economist print edition

He may be reforming but he is also seeing young rivals off the field

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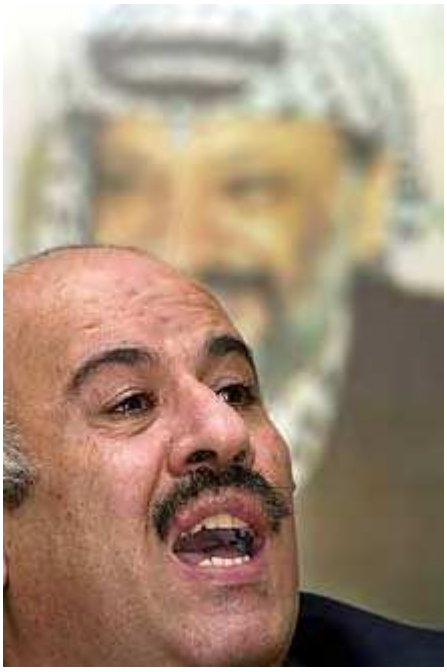
AP



Who killed JR?

CAST into outer darkness by George Bush, held in besieged impotence by Ariel Sharon, Yasser Arafat is responding to his twilight days in characteristic fashion. There is to be no graceful relinquishing of the throne, rather an aggressive retrenchment of his leadership.

Now that Israel has reoccupied the West Bank, the Palestinian Authority (PA) has banned all dealings between the army and Palestinian mayors, partly at least to prevent their being cultivated as an alternative, local leadership. The meetings this week between Shimon Peres, Israel's foreign minister, and the PA's new finance and interior ministers were held only with Mr Arafat's express permission.

Palestinian reform, widely called for, is being implemented in a way that is designed to help Mr Arafat. In line with American, Arab and European edicts that he unify the PA's many security forces, he has in the past two weeks dismissed four security chiefs, and put the forces under one command, headed by the new interior minister, Abdul RazekYahye.

The firing of two of the men—Ghazi Jabali, the Gaza police chief, and Mahmoud Abu Mazouq, the head of civil defence— went down well. Both date back to the Palestine Liberation Organisation's exile days in Tunis, and both were hated by local Palestinians for their corruption, and for their brutality against political opponents, including the young guard in Mr Arafat's Fatah movement. And the unconfirmed dismissal of Tawfiq Tirawi, the West Bank's intelligence chief, was probably inevitable since he has recently been put on Israel's “most wanted” list.

But the dismissal of Jibril Rajoub, the head of the West Bank's Preventive Security Force (PSF), has proved much more controversial. According to PA security sources, no “outside force” demanded Mr Rajoub's sacking. It is easy to see why. Over the seven years of the Oslo process, Mr Rajoub established sound relations with Israeli, American and European intelligence services. And during the *intifada*, the PSF has been one of the few PA security forces not actively engaged in fighting.

Moreover, unlike the other sacked men, Mr Rajoub is an “insider”. He hails from Dura, near Hebron, and has built his force almost exclusively from West Bank Fatah activists. In the past, he has used this local base to distance himself from certain of Mr Arafat's policies, whether it was the arrest of Islamist political leaders, or allowing grassroots militias to run free.

He has also used it to criticise “some people” in the leadership, who, he alleged, were leading Mr Arafat astray. In April Mr Rajoub all but accused Muhammad Dahlan, who recently resigned from being Gaza's security chief but has since been offered the job of Mr Arafat's security adviser, of conniving with Israel's aerial bombardment of his headquarters in Ramallah to discredit him in the eyes of his people. To save his men, Mr Rajoub was forced to hand Israel six wanted activists.

Mr Rajoub, who called his dismissal “disrespectful”, accepted it only after a 48-hour stand-off. In the meantime, he had prodded his followers to protest. They called for his reinstatement or, at the very least, asked that his successor should not be Zuhair Manasara, the PA's former governor of Jenin. Mr

Manasara is another Tunis veteran who is liked by diplomats and journalists because of his fluent English, but loathed by locals because of his flights from Jenin in the face of Israeli invasions. His appointment is now “frozen”.

But Mr Arafat has made his point, say his Palestinian critics. His strategy is now one of survival. And, for this, he does not need young local heroes, but old Tunis hands who, owing loyalty only to him, can be sacked or promoted with impunity.

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Iraq, Jordan and America

A horrid sandwich

Jul 11th 2002 | AMMAN
From The Economist print edition

The Jordanians find themselves trapped between America and Iraq

Get article background

AT IRAQ'S annual trade fair in Amman, Jordanians sample the 400 types of date on display, and wonder at the latest Iraqi-made air-conditioner that looks and roars much like a tumble-drier open on one side. On their way home, they stop off for some Kentucky Fried Chicken. Which way do you bend when your two best friends, or at any rate benefactors, are Iraq and the United States? The Jordanians feel squeezed into a dangerously uncomfortable sandwich.

They advocate non-alignment, which they prefer to describe as a moderating influence. No to sanctions on Iraq, say officials, and no to the boycott of American goods. But this studied neutrality is getting harder to preserve. As the war-drums beat, Jordan has found itself vociferously denying claims that it has been singled out as a preferred staging-post for an American strike on Iraq. There is not a single soldier on Jordanian soil, Marwan Muasher, the foreign minister, repeats like a mantra, nor will Jordan allow itself to be used as a launching-pad for an invasion.

Jordan has much to loose from an impending war on Iraq. Although Iraqi-Jordanian relations have gone through rocky times since the Gulf war, Iraq for half a century was Jordan's traditional market. Nowadays, the kingdom still relies on Saddam Hussein for all its oil, half of which he gives Jordan free, the rest at a discount paid in vegetables and other commodities. Jordan's attempts to diversify its energy sources have been stymied by Saudi Arabia, still piqued by Jordan's ambivalence during the Gulf war. “We thank God for our water, we thank Saddam for our fuel,” is a common Jordanian refrain.

Lots of carrots, when's the stick?

To wean the Jordanian street off its love for Saddam, the Bush administration is seeking to provide military and economic aid worth well over $300m. Jordan has also benefited from preferential loans from the World Bank and IMF. It's a game of dependency, says a former royal adviser. At the same time, America has yanked Jordan's trade westwards, sponsoring special industrial zones for Israeli and Jordanian ventures as a first step to binding Jordan's economy to Israel's. Despite the *intifada*, the zones employ 30,000 people and produce $300m worth of trade. A noisy anti-normalisation lobby seeks to reverse this reorientation, but to little effect.

Jordanians now have to worry about what America's fortress of an embassy, defended by gun-turreted armoured personnel carriers, may soon be demanding of them, in return. Insiders say that, ever since the 1980s, Jordan has sought to resist American requests to pre-position weapons in the country. But the pressure is now much more intense, with reports of a Pentagon plan to base military aircraft in eight states in preparation for an attack on Iraq.

King Abdullah shivers at the prospect of repeating his father's 1990 mistake of appearing to side with Mr Hussein against George Bush senior. With half Jordan's population Palestinian-born, helping a strongly pro-Israeli America to wage war on Iraq could cause him acute security problems. Yet, with George Bush junior telling the world that you are either with us or against us, the choice now for Jordan is even starker than it was in 1990.

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Madagascar at peace

A president flees, another celebrates

Jul 11th 2002 | ANTANANARIVO
From The Economist print edition

Civil war has been averted. What now?

FOR six months, this huge rainforested island-state was divided. Two men claimed the presidency, rival army units squared off, and a blockade cut off supplies to the capital, Antananarivo. But on July 5th, the less popular president, Didier Ratsiraka, gave up and fled, and Marc Ravalomanana, a dapper dairy tycoon, is now firmly in charge.

Mr Ratsiraka, a retired admiral who ruled Madagascar on and off since the 1970s, admits that Mr Ravalomanana won more votes than him at an election in December, but claims that he failed to win the outright majority he needed to avoid a run-off. Mr Ravalomanana says he did win a majority, and a panel of judges agreed. But the clinching factor was that Mr Ratsiraka's troops, when confronted with Mr Ravalomanana's, tended to run away. This week, Mr Ravalomanana's men captured Mr Ratsiraka's last stronghold without much difficulty. Had Mr Ratsiraka not flown to France, he might now be struggling to digest prison food.

In Antsiranana, a northern port town, throngs filled the streets to welcome Mr Ravalomanana's men. In the main square, a loudspeaker boomed the undisputed president's name, to the applause of thousands of citizens, who had painted their faces jubilant shades of green, white and any other colour they could get their hands on. They had cause for relief: in the previous two weeks, Mr Ratsiraka's militia had terrorised the town, tossing grenades, looting shops and taking people hostage. Now, the thugs were gone, the curfew was lifted, and the party lasted all night.

But what of the morning after? It was not the bloodiest of civil wars: the death toll is probably in the low hundreds. But the economic damage was immense, and in a country as poor as Madagascar, that means people go hungry.

There are reasons for optimism. Mr Ratsiraka was an indifferent president. Though he gave up Marxism and had not had any demonstrators massacred since the early 1990s, he presided over a crooked regime. Mr Ravalomanana's record as mayor of Antananarivo suggests he may do better. He found the city filthy and anarchic, and with a businessman's can-do spirit, he cleaned it up. But some worry about his authoritarian streak. His capital clean-up involved bulldozing shacks and banishing hawkers from the pavements. And now that the war is over, he has vowed that those who committed “crimes against the state” will be tried.

France and America have recognised Mr Ravalomanana as president. The African Union, the new regional block (see article), has not, calling instead for fresh elections. Meanwhile, there are signs of recovery. Petrol, unavailable for months because of roadblocks, has started to flow again. Bars bustle, and families picnic once more on the beaches. Even the poorest are hopeful. Harrys Razanamanitra, who ekes a living selling empty cans and broken glasses, can barely afford to buy food but thinks the new president will make life better. “I have faith,” he says.

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African Union

Try, try again

Jul 11th 2002 | JOHANNESBURG
From The Economist print edition

The continent's new union should have more teeth than its predecessor

THIS week, Africa's leaders threw a party in Durban, South Africa, to bury the Organisation of African Unity (OAU) and praise a new African Union (AU). Swirling parachutists, Senegalese footballers, Zulu dancers and gospel choirs created a carnival mood. Libya's president, Muammar Qaddafi, strutted in purple robes, calling for a single African country and congratulating Africans for shrugging off colonial repression. A pride of presidents said nice things about peace, growth and democracy. Kofi Annan, the UN secretary-general, wished everyone luck, but deplored the continent's wars.

Now the fun is over, what has really changed? The 39-year-old OAU was long dismissed as ineffective, though it did help preserve the idea of sovereign borders. It opposed colonialism and observed the end of various wars, but was too feeble to challenge any of Africa's dictators. One butcher, Uganda's Idi Amin, was picked as OAU chairman.

The AU is supposed to do better. Thabo Mbeki, South Africa's president and the AU's first chairman, says he wants “a continent of democracy”. The AU's leaders have promised eventually to create a pan-African parliament, a court of justice, a central bank and a shared currency. They have also set out common electoral standards which demand, for example, that independent observers be welcomed before and during any national vote. Well and good, but such promises have, in the past, too rarely been kept. Zimbabwe's election in March fell far short of the proposed electoral standards, but African leaders quickly approved it.

One proposal, however, shows promise: an African “peace and security council”, with the authority to send troops to stop war crimes and genocide. The 15-seat council will have five semi-permanent members (one from each region), and ten others elected for two-year terms. To carry out the council's wishes, an African standby peacekeeping force is also proposed. This is unlikely to be large or well-equipped, but it might at least show willing, and thereby encourage UN or other non-African forces to intervene, too. The hope is that this would prevent future catastrophes like the 1994 Rwandan genocide, during which 800,000 people were murdered but outsiders failed to react. If the AU could make Africa less violent, Africans would really have a reason to party.

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Europe's farms

Will these modest proposals provoke mayhem down on the farm?

Jul 11th 2002 | BRUSSELS
From The Economist print edition

The European Commission has proposed ways to reform Europe's wasteful and protectionist common agriculture policy. Expect stiff opposition

Get article background

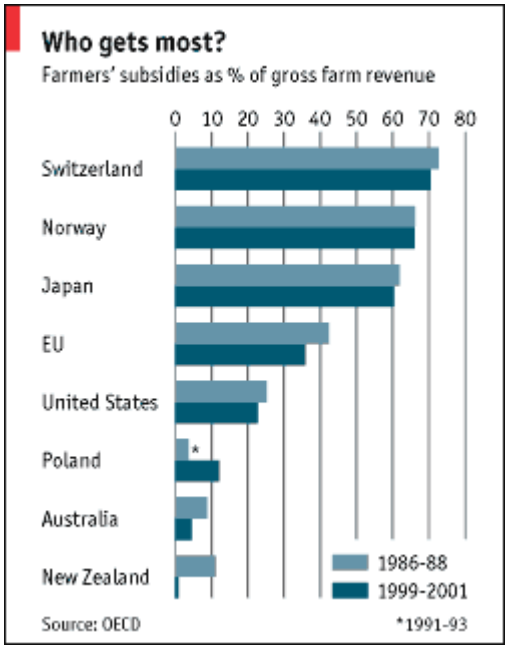
WHAT is the European Union for? To promote peace? To project European power? To create a single European market? All of the above are popular answers in Brussels. But look at what the EU actually spends its money on, and you may be forced to conclude that its real purpose is to subsidise agriculture. Although just 4% of the EU's population work in agriculture, subsidies for farmers are the budget's biggest single item. The *euro*40 billion-plus ($39 billion) dispensed every year through the common agricultural policy (CAP) consumes almost half of all EU spending.

The situation is even worse than those numbers suggest. A recently released study by the OECD, the Paris-based rich-country club, suggests that when indirect subsidies such as price supports and tax-breaks for farmers are added to direct payments, EU farmers got *euro*104 billion in aid in 2001 compared with around *euro*50 billion in subsidies in the United States. Farmers in the EU get about 35% of their income from subsidies, compared with 21% in the United States and just 1% in New Zealand.

European consumers and third-world countries pay a heavy price for all this generosity. The OECD estimates that Europe's agricultural protectionism adds 15-20% to the price of food in the EU, costing the average family around *euro*600 a year. Meanwhile farmers in poorer countries are hobbled in their efforts to export to Europe, and find subsidised European food dumped on their domestic markets.

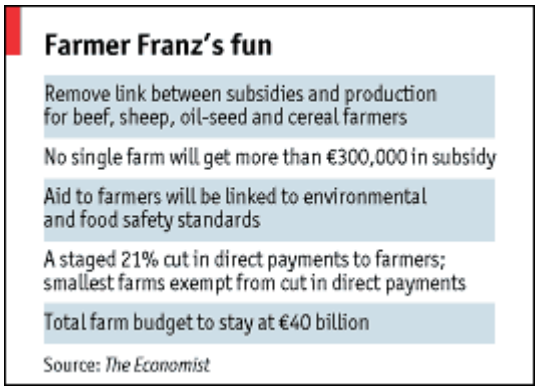
The EU likes to boast that it has the largest aid budget in the world. But its own farm policy inflicts massive indirect damage on the world's poor. Even apparent acts of EU generosity are carefully tailored to suit the powerful farming lobby. When the EU offered last year to drop all tariffs on goods from the world's 49 poorest countries, partial exemptions were arranged for key farm products like sugar and rice.

Given the scale of the problems caused by the CAP, the reforms proposed by the European Commission on July 10th seem modest. Franz Fischler, the commissioner in charge of agriculture, is not proposing that the overall level of EU subsidies will go down. Rather, he is suggesting tweaking the policy in ways that will make it less perverse and which may eventually make it easier to cut overall spending.



His most important proposals are to "decouple" subsidies and production and to redirect a lot more CAP spending towards environmental and rural-development projects. "Food security" in Europe was achieved decades ago. Subsidies now simply encourage wine lakes and butter mountains, and the sort of industrialised farming that excites suspicion among consumers and damages the environment. Under a reformed CAP, farmers will be encouraged to be greener. More money will be channelled to social goals, such as ensuring that people are encouraged to keep land in use and to keep living in the countryside. Subsidies would also be gradually diverted away from the largest farms, with caps on payments to the biggest farmers.

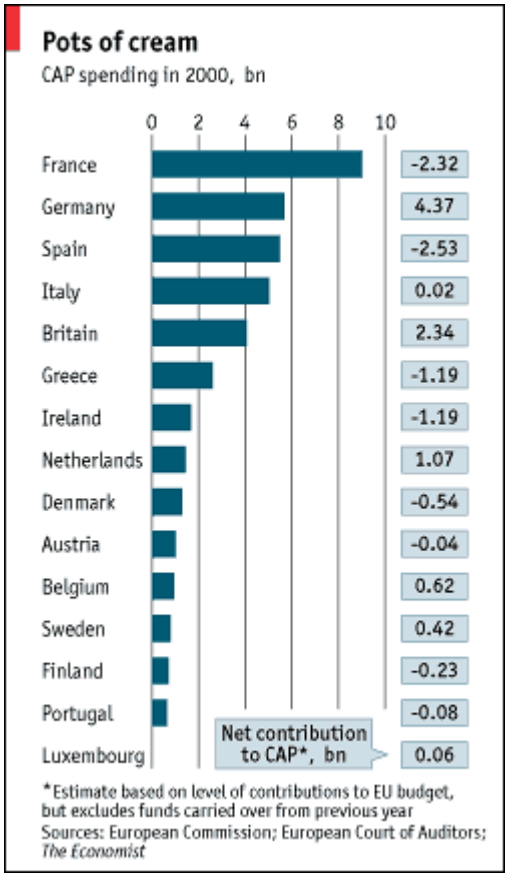
Mr Fischler's proposals are not just driven by the EU's politics but are being made with an eye on the new round of global trade talks being held under the auspices of the World Trade Organisation (WTO). Farm subsidies will be dealt with in the current global trade round. By re-orientating the CAP now, Mr Fischler hopes to strengthen the EU's hand at the WTO. The new kinds of subsidies that he suggests would distort world trade less and thus be less likely to be struck down by the WTO.



EU officials are at pains to point out that while their overall level of subsidies may still be higher than those in the United States, the Union is now "moving in the right direction", while the new American farm bill would grant $190 billion of old-style production subsidies to American farmers over ten years. Mr Fischler says with some pride that, if his proposals are adopted, the EU will at last be able to go on the offensive over agriculture at the WTO. And he urges the French, who have made it clear that they will oppose his reforms, to remember that "they will have to accept a changed system anyway as a result of the WTO negotiations."

Unfortunately, these words of wisdom are unlikely to be heeded in Paris. France is easily the biggest beneficiary of the EU's current subsidy regime, and French governments live in terror of militant farmers dumping manure on Paris boulevards or blocking motorways with their tractors. The new conservative French government may well prove even more hostile to CAP reform than the previous Socialist one.

Indeed, the only countries that the commission can rely upon to back its proposals are Germany, Britain, the Netherlands and Sweden. Not entirely coincidentally, all of this lot are net payers into the Union's budget and put more money into the CAP than they get out of it. But it looks as if there are more than enough countries that do well out of the current regime to water down even Mr Fischler's modest proposals.



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Justice in France

Soft on politicians, hard on the rest?

Jul 11th 2002 | PARIS
From The Economist print edition

The new government may treat some criminals more leniently than others

FORGIVENESS for France's political elite? Or will their sins—of filling party coffers with corporate kickbacks, finding fictitious jobs for the party faithful, and so on—still be punished? For the moment the question remains unanswered. Of the thousands who have broken France's thousands of laws, those who apparently deserve immediate mercy are the motorist who has failed to pay his parking ticket or produce his documents or—as a sop to the traditional feeling that street politics are part of the national heritage—the trade-union demonstrator whose protest went a touch too far.

That at least is what the presidential amnesty put to parliament this week proposes; since article 17 of the constitution gives the president "the right to pardon", an amnesty always follows a presidential election. The only surprise is that this time it is less generous than usual. It fails, for example, to let off the road hogs who make France's roads among the more dangerous in Europe. And José Bové, a much-admired anti-globalist now in jail for trashing a McDonald's site, has not been spared either; in protest, he has gone on hunger strike.

But the bigger issue remains, and the Socialist opposition is not alone in suspecting that President Jacques Chirac and a pro-Chirac government will at some point, possibly quite soon, in the five-year term of the new parliament declare an amnesty for what are delicately called "political-financial offences". Certainly, the political logic is tempting. After all, the president, protected from questioning by his constitutional immunity, is one politician allegedly implicated in the offences. So, too, is his political heir-apparent and former prime minister, Alain Juppé, who has been under formal investigation for four years. And so are many other leading politicians, including some on the left, such as Henri Emmanuelli, a former treasurer of the Socialist Party.

The problem, however, will be translating political logic into electorally acceptable fact. Hence the idea being whispered but not yet openly advocated by pro-government politicians that a "statute of limitations" should apply to the "misuse of corporate assets", the catch-all charge that applies to most of the political-financial offences. Since most of the present scandals date back to the 1980s and early 1990s, and since many of the investigations have been going on for five years or more without anyone being brought to trial, a limit of, say, three or five years would lift the politicians neatly off the hook.

But lesser mortals will find wriggling off the judicial hook rather harder in future. Next week Dominique Perben, the justice minister, will present his cabinet colleagues with a "get tough" programme to fight France's criminals, especially young ones. There will, for example, be new youth-detention centres. Investigators will have the right to put children as young as 13 into preventive custody. And recent legislation on the "presumption of innocence" will be modified to make bail harder to get.

The opposition says all this will "set the clock back 20 years". The government will claim that adding another 11,000 prison places to the 47,000 already in use, plus 18,000 more police and *gendarmes*, plus a 50% rise in the money allocated in the budget to the ministries of justice and the interior, is precisely what the voters asked for. But will it actually work?

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An Irish scandal

The fortunate Cayman Islands

Jul 11th 2002 | DUBLIN
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Lots of money flitted across the Atlantic. The taxman never knew

CHAOS theory avers that a butterfly flapping its wings in one continent may cause a hurricane in another. Ben Dunne, a very rich Irishman, seems to have proved the theory right. Ten years ago he threatened to jump from the 17th-floor balcony of a hotel in Florida rather than be arrested. Indirectly he provoked the hurricane that on July 6th finally hit Ireland's political, business and professional elite when a 10,000-page report of an investigation by High Court inspectors into nearly 30 years of tax evasion was published in Dublin.

It was his cocaine-sniffing habit, for which he was arrested in Florida, that cost Mr Dunne his job as chairman and executive director of Dunnes Stores, a big Irish food and textile retailer. In a bitter legal row that followed with other members of the family-owned company, he made private claims, later made public, that he had paid large sums to Irish politicians. And so indeed, decided a tribunal investigating the affair in 1997, he had.

One beneficiary of his largesse had been Charles Haughey, a disgraced former prime minister, who got the equivalent of *euro*1m (nearly $1m at today's rates) via a Cayman Islands bank account. The transaction was facilitated by Des Traynor, a Dublin businessman, now deceased, who began his career as an articled clerk in Mr Haughey's accountancy practice. He remained a lifelong admirer, and discreet money manager, for Mr Haughey—and for some of his wealthy friends. All trusted him completely, regarding this genial gnome as something of a financial genius.

Nosing into Mr Traynor's affairs turned up another trail. Since 1976 he had been running Guinness & Mahon (Ireland) Ltd, a small Irish merchant bank. But from the early 1970s he also ran, from Dublin, a secretive outfit called (after sundry name-changes) Ansbacher Cayman Ltd. Its banking services enabled many of the 179 people named in the new inspectors' report to salt away undeclared cash. Curiously, its illegal activities escaped detection by the Central Bank, one of whose board members the inspectors name as an Ansbacher client. Nor did the taxmen look too hard.

The list of Ansbacher clients includes some former captains of industry and commerce, leading lawyers, accountants, architects, doctors, hoteliers, builders and property developers. To Mary Harney, the minister from a minor coalition party who pursued the inquiry for five years, defying legal challenges and some opposition, the report represents “a damning insight into the world of conspiracy, fraud and tax evasion over a long number of years”. She has described it as a watershed in Irish life.

Really? Prosecutions look unlikely: time has gone by, documents have been destroyed. And past governments have preferred the carrot to the stick in matters of tax compliance: the past 15 years have brought two general tax amnesties. A far bigger tax scam, involving some 50,000 bogus non-resident accounts, has so far seen fewer than 4,000 people lodge *euro*227m to settle their cases. The Ansbacher equivalent, to date, is *euro*17m.

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Greece and terrorism

A breakthrough beckons

Jul 11th 2002 | ATHENS
From The Economist print edition

The Greeks may be poised to nab their home-grown terrorists, at last

IT WAS the mistake that Mihalis Chrysohoidis, Greece's public-order minister, and teams of police from the United States and Britain had been waiting for. After 27 years and more than 20 assassinations of foreign diplomats, American servicemen and Greek businessmen, the N17 terrorist organisation (named after November 17th 1973 when a repressive military regime crushed a student revolt at Athens polytechnic university) slipped up. A bomb carried by Savas Xiros, a 40-year-old painter of religious icons, exploded prematurely on June 29th close to the offices of a Greek shipping company in Athens's port of Piraeus.

EPA

They may at last be closing in

Mr Xiros was seriously injured but survived. Six days after the explosion, a magistrate was questioning him in hospital. Forensic tests linked him to at least two crimes by N17: the killing of Costas Peratikos, a Greek shipowner in 1997; and a rocket attack against the home of Germany's ambassador to Greece in 1999, during the Kosovo war.

The capture of Mr Xiros led to the discovery of two caches of weapons and documents fingering N17 in flats in residential districts of Athens. Greek investigators say they contained, among other incriminating evidence, some of the more than 300 anti-tank rockets stolen by N17 from an army base in northern Greece in 1989, a typewriter used to produce the group's early proclamations, and a red flag emblazoned with N17's logo, a five-pointed star.

The breakthrough could not have come at a better time for Costas Simitis, Greece's pro-western Socialist prime minister. With anxieties mounting about security for the Olympic Games due to be held in Athens in 2004, Greece's failure to bring N17 to justice had been causing increasing embarrassment. Retired American diplomats had claimed that members of previous Socialist governments had obstructed anti-terrorist investigations.

N17 first struck in 1975, when it killed Richard Welch, the CIA station chief in Athens. For years the group's idiosyncratic mix of Marxism and nationalism struck a chord with a strongly anti-western segment of Greek public opinion. Few witnesses of N17 attacks ever spoke up.

Recently, though, attitudes have changed. Since the group's last assassination—the drive-by shooting in June 2000 of Britain's defence attaché—a team from Scotland Yard has been based in Athens. It has

brought a methodical style of investigation that is new to Greece, from collection of material for DNA-testing to knocking on the doors of old-fashioned left-wingers. Privately the team gave itself two years to crack N17, a deadline that it seems to be meeting.

Public opinion has swung behind the investigators, thanks in part to Heather Saunders, the British attaché's widow, and Nikos Peratikos, the late shipowner's brother, who launched a campaign to promote awareness of N17's victims. A new anti-terrorism law providing for trials in camera and witness-protection schemes was approved last year. As a result, more Greeks have been calling the anti-terrorist hotlines with information. For the first time, opinion polls show that most Greeks want the police to nail the terrorists.

So far, so good. Mr Xiros, according to the police, is a senior member of N17, perhaps its head of operations. More than 150 people have been questioned since he blew himself up. A round of arrests is predicted over the next few weeks. But the group's ideological leaders, believed to be in their 60s, are still at large and probably living abroad. Until they are brought to book, Mr Simitis cannot claim to have crushed N17.

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Germany's next government

Kaleidoscope

Jul 11th 2002 | BERLIN
From The Economist print edition

Polls suggest September's election may lead to a grand coalition of right and left

WHAT hue Germany's next government? A couple of months back, the ruling “red-green” coalition of Social Democrats and Greens looked done for and the “black-yellow” alliance of Christian Democrats and liberal Free Democrats, ousted in 1998, looked all set to return. But as the Social Democrats continue to creep back up in the polls and the liberals slide down, September's general election is becoming ever harder to predict. Almost any colour combination now seems possible.

Gerhard Schröder would prefer to continue with his red-green coalition. Edmund Stoiber, his conservative challenger, fancies a black-yellow one with the liberals. But on today's poll ratings, neither grouping would secure an overall majority in Germany's lower house of parliament. Hence the search for possible new combinations.

One would be to add the ex-communist Democratic Socialists to Mr Schröder's coalition. But he has rejected out of hand even indirect collaboration with them. His party and theirs are allied at state level in Berlin and Mecklenburg-West Pomerania. But, for him, that is one thing; a national coalition with a party that says no to Germany military missions abroad would be quite another. Aides say he would sooner go into opposition than do such a deal.

Could he turn to the liberals, who say they are as ready to play footsie with him as with Mr Stoiber? Mr Schröder once said he might. But many in his party would dislike sharing power with one dedicated to a partial dismantling of the welfare state. Conclusion: if Mr Schröder wins but has no majority with the Greens alone, he would probably aim for a “grand coalition” with the conservatives, despite his present denial.

Some Germans, including Michael Sommer, leader of the DGB, the main trade-union confederation, see this as the best, perhaps only, way to push through the radical reforms that the economy urgently needs. Others, not least Mr Stoiber and Mr Schröder, say it would lead to a harmful political stalemate and foster extremist parties. Mr Stoiber this week promised to “do everything” to avoid it.

Yet the polls suggest this is the likeliest option—though without one or other of the two leaders. If the conservatives do best in the election, Mr Schröder would be unlikely to accept a ministerial post under Mr Stoiber. If the Social Democrats win, Mr Stoiber would probably retire to his home state of Bavaria, and its Christian Social Union there, leaving Angela Merkel, leader of the Christian Democrats, to handle the junior coalition partner's role.

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Poland's rocky government

Bad vibrations

Jul 11th 2002 | WARSAW
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The country's new finance minister may not revive its fortunes

IS THE embattled prime minister of Poland, Leszek Miller, still in charge? Judging by recent events, the answer is unclear. Mr Miller had been expected to appoint one of his own men to replace Marek Belka, the finance minister who resigned on July 2nd after failing to stop the country's enormous budget deficit from widening still further. Instead, the provincial bosses of Mr Miller's ex-communist Democratic Left, who have been nicknamed "the barons", bullied him into giving the job to their man, Grzegorz Kolodko, who served as finance minister between 1994 and 1997, the last time their party was in office. The barons also encouraged Mr Miller to kick out the ministers of justice and culture and install one of their own as the new justice minister: Grzegorz Kurczuk, the party's powerful boss in Lublin, in the country's south-east.

The long summer holidays cannot come early enough for Mr Miller. He has been haemorrhaging support and trust for months. Even the hoped-for feel-good factor promised by Poland's footballers in the World Cup fell flat when the team was cut to ribbons by the novices of South Korea. Mr Miller's relations with the president, Alexander Kwasniewski, never good, have deteriorated sharply. The whisper among pundits in Warsaw is that Mr Kwasniewski wants to replace Mr Miller with someone from the more economically liberal and more plainly Europhile bit of the Democratic Left.

That is unlikely for some time. Mr Miller still commands the respect of most ministers and of the broad centre of his party. His fate may depend, all the same, on how Mr Kolodko performs in his new post. First time round, he presided over a period of heady economic growth. He hopes to boost growth again by devaluing Poland's zloty and tying it more closely to the euro.

But first he must calm the markets, which reacted glumly to Mr Kolodko's reappointment. Bankers remember him as a big spender with puffed-up ambitions. Many doubt he is the man to rein in public spending. They point out that even Mr Belka, who struggled desperately to cap public spending, has been unable to prevent the state budget deficit rising from $3.5 billion in 2000 to $10 billion, the latest probable figure for this year.

As he departed, Mr Belka declared himself "burnt out". His ministerial colleagues in charge of Poland's health care and infrastructure have already called for more cash to placate an increasingly surly electorate. The head of Poland's central bank, Leszek Balcerowicz, is under attack from the big spenders. The European Union, already worried by the sight of Poland slipping back from being one of Central Europe's bounciest economies to one of its most sluggish, is looking on askance. If Mr Miller loosens his purse strings more, the case for slowing down the EU's enlargement, still more or less scheduled for 2004, may gather weight.

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Charlemagne

The Netherlands' Jan Peter Balkenende

Jul 11th 2002
From The Economist print edition

A Christian Democrat hoping to govern like one—so long as he can keep his cabinet in one piece

HE IS a professor by trade, a thinker, nay: his website offers a seven-page lecture of his views on Dutch society, and that's just one in a five-part series. He looks the part too: with his owlish specs and schoolboy haircut, 46 going on 14, you'd guess. And his political experience? Well, Jan Peter Balkenende entered parliament all of four years ago, and became the leader of his Christian Democrats only last October—and that mainly for lack of anyone likelier to pull together a party hurt by scandal and, after eight years out of power, heading nowhere. Not that he looked likely to lead it anywhere much else in the general election due in May. Yet what is Mr Balkenende now? Prime minister designate of the Netherlands.

For that, he can thank, above all, the maverick Pim Fortuyn, whose party—well, "party"—burst into view, evicting Rotterdam's long-ruling Labour council, in local elections in March. Mr Fortuyn said aloud what many voters had not dared to say for themselves: that they were tired of crime, of ill-assimilated Muslim immigrants and, more widely, of orthodox politicians too busy talking cosily with each other to notice these discontents. Nationally, Labour, the Christian Democrats' historic rival, was already looking tired. Wim Kok and his "purple" coalition—his party, plus the free-market Liberals and left-leaning D66—had held office for eight years, and the popular Mr Kok, ready to retire, had handed party leadership to a less than dazzling heir. Now, suddenly, tiredness began to look like feet of clay.

Even so, many foresaw the Fortuynists fading before the general election. They didn't, not least because Mr Fortuyn was murdered just before polling day, and his name—still on the list—drew as many votes as he might have alive, winning his party 26 of the 150 seats in the lower house. But the real winner was Mr Balkenende. He had wisely chosen not to treat Mr Fortuyn as something that had crept out of the woodwork. Labour took the opposite line—and just 23 seats. And the Liberals fell apart.

With his 43 seats, Mr Balkenende rules the roost. Back to normal, one might think. Until 1994, "Christian" parties had held the prime ministership for most of the years since 1945, and had at least a share of power, thanks to the Dutch belief in strictly proportional representation, for all of them. Then, unified since 1980 under a single, Christian Democratic, banner, they got a shock: in 1994 the victorious Labour Party formed a coalition without them, walloped them even worse in 1998 and did it again. But in fact the coalition ministry that Mr Balkenende is now forming with the Fortuynists and the Liberals will be no more "normal"—and probably harder to keep in one piece.

Until 1994, "Christian" parties had held the prime ministership for most of the years since 1945

His is still a confessional party, the heir of three, one Catholic and two Protestant, born in the days when Dutch society, from politics and trade-unionism to television and amateur sport, was a mosaic of groups defined by sect, distinct but happy to co-exist: this, not a melting-pot, was the Dutch way of doing it. The Fortuynists mix xenophobic populism with that same mosaic idea: be what you are but fit in with the rest of us. Labour, in contrast, began as a class party. Yet the Christian Democrats share with it a belief in community, whereas their Liberal partners, another class party, are free-market individualists.

These distinctions are not just academic. The struggle between clerical and lay drove much of mainland Europe's politics in the 19th and early 20th centuries. To Britons or Americans, whose countries never experienced it, today's Christian Democrats look much like any class party of the centre-right. Not so. Even now, there are real differences. Notions of togetherness and of care for the weak that might in Britain seem vaguely of the left, are (at least in theory) part of the Christian Democratic agenda, thanks to the social doctrine of the church. The "third way" was around long before Tony Blair, a Christian

Democrat *manqué* if ever there was one, thought he'd invented it.

This was so in the Netherlands as elsewhere. As late as 1968, a leader of its then Catholic party, asked what his party stood for, opened his reply thus: “We see the human being as the creature of God.” Recently, it is true, one party bigwig described it as now “post-Christian”. But the past is not dead. For all its down-to-earth detail and fiscal arithmetic, the three-party accord that let Mr Balkenende this week start forming a cabinet struck one Dutch newspaper as “a lesson in Christian Democratic ideology”. Not enough so, some of his voters feel, but so it is, and the political results may not be academic. Is the immigrant, for instance, primarily a much-needed worker, or, as both Christians and Fortuynists see him, an element, welcome or not, of society? The accord promises some “integration” measures that will in sum discourage immigration; they will also be anti-market.

The Fortuynist conundrum

Still, it is the Fortuynists who pose the big problem. Will they accept the discipline of coalition? After a leadership struggle, they have a new chief, Mat Herben, and a bit more coherence. But till when? Already losing popularity, they can hardly afford to quarrel. But excuses for a fight, with their partners or each other, will not be hard to find. Everyone wants less crime, but the Fortuynists' call for a super-ministry covering both police and justice was rejected. The three parties agree on less government, but not nearly as much less as Mr Fortuyn wanted. His demand for elected mayors, in place of today's appointed ones, was accepted; his ideas for direct democracy got short shrift.

And a new, closer-to-the-people, more responsive politics? Mr Balkenende talks of it, but one can wonder. Will the parties really learn to listen to voters, not each other? Will they alter the centralised party-list electoral system? These laments are not new. They were loud in the 1960s; write “Fortuynists” in place of “D66”, the—otherwise very different—mould-breakers of that era, and those days' accounts of the issue could stand almost verbatim today. Here at least, normality indeed reigns.

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Saving

Cutting through the jungle

Jul 11th 2002
From The Economist print edition

The government wants to reform the savings industry because Britons need to save more. But it is partly to blame for what has gone wrong

THE problem is undeniable: the British do not save enough. According to one estimate (see bar-chart below), the annual shortfall amounts to £27 billion ($42 billion) a year. As a proportion of household income, the gap is especially large among the worse-off. The shortfall matters all the more because private saving contributes much more to retirement income in Britain than in most other countries.

But faith in the life-insurance industry—the principal provider of individual pensions and other forms of long-term saving—has been undermined by scandals like the mis-selling of personal pensions. This is especially unfortunate since many employers are ceasing to offer final-salary pensions to new employees. A report on occupational pensions for the government this week by Alan Pickering, former chairman of the National Association of Pension Funds, brought scant comfort. Describing his proposals as the last chance for voluntary pension provision, Mr Pickering called for fewer regulations and less generous benefits.

With more and more working people having to take responsibility for their retirement saving, it has become more essential than ever that the long-term savings industry can deliver. It cannot in its present form, said another far-reaching report this week. On July 9th, Ron Sandler, a former chief executive of Lloyd's of London, the insurance market, revealed the findings of a year-long review into an industry that manages a trillion pounds-worth of funds.

The big piggy bank...
Funds under management, £bn, 2001

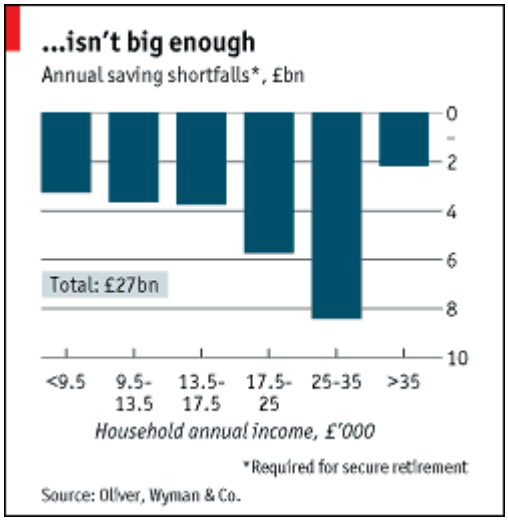
Savings category	Value
Individual pensions*	560
Life savings products*	260
Retail unit trusts	132
Retail investment trusts	27
Total	979

Sources: ABI; HM Treasury *End 2000

Life-insurance companies are the dominant providers of long-term savings (see table above), but unit trusts (mutual funds) also play an important part. Investment trusts—quoted companies that invest in a portfolio of shares—are another vehicle for pooled saving. Much of the business is sold through small-scale financial advisers, although banks also play an important part in selling such savings products.

Mr Sandler, backed by a team of Treasury officials, put this industry under the microscope and did not like what he saw. He had three main complaints. First, the industry suffers from weak competition, in large measure because the interests of consumers

and their financial advisers are not aligned, since advisers are generally paid by providers through commissions. So there is insufficient pressure to bring down costs and deliver savings products as cheaply as possible. Second, low-to-middle-income customers are ill served because the fixed cost of sales advice—finding out about the customer's needs and ensuring that products match them—makes them less profitable or inflicts losses. Third, the industry does not generally offer value-for-money products, but rather an array of proliferating instruments that are difficult to compare and understand. The with-profits policy, a mainstay of the life-insurance industry, is especially opaque, says the review.



From the diagnosis follows the cure. Mr Sandler calls for a new range of standardised low-cost products. These would extend the key features of the stakeholder pension—no initial commission on saving and a cap on charges of 1% of the fund—to other savings products such as unit trusts and with-profits policies. The aim is to create a small, standard set of savings products that are so simple and safe that they could be sold without expensive financial advice—so allowing low-income households much readier access to saving. Crucially, there would be less need to document the sales process. If these new cheap-and-cheerful products were to fly off the shelves—which hasn't been the case with stakeholder pensions—they would act as a battering ram to create the "1% world".

Simplification is the big idea—as with Mr Pickering's report on occupational pensions. But this begs the question: why is the savings and pension industry so complex? Awkwardly for the Treasury, which commissioned the Sandler report, the answer lies close to home. There is one overriding reason why the industry is so complex: tax. Ned Cazalet, a consultant to the industry, says "fundamentally the problem is that the tax regime in the UK is nuts, incomprehensible even to experts." The aim of Mr Sandler's new product range is simplicity, but Mr Cazalet is sceptical about whether it will work. "You don't get rid of existing products, and that itself adds to overall complexity because people have to make decisions about whether to continue them."

The Sandler review recognises the role that tax plays in contributing to complexity and calls for simplification of the more than 20 tax regimes that govern pensions. But this will be far from easy since they enshrine past contractual rights, such as allowable contribution levels and benefits. Some of the "simplification" agenda will be far from popular if it removes tax concessions, like the one allowing higher-income taxpayers to defer taxation on capital withdrawals from with-profits bonds.

The jungle grows

Even supposing the government were able to cut through the existing tax jungle, what help would this be if it continues to add complexity? Next year will see the introduction of the pension credit, which will provide means-tested benefits to half of all pensioners. Its effect will be to impose a marginal tax rate on income from saving among these pensioners of at least 40%—the rate at which the means-tested benefit is phased out. The key weakness of the Sandler package, says Tim Keogh of Mercer Human Resource Consulting, is that "it doesn't actually do anything to incentivise the low-to-middle earners who haven't got any spare funds to invest long-term and who might well feel that they will be depriving themselves of a government safety net unless some of the means-testing is rolled back."

The long-term savings industry deserves the stick it gets from Mr Sandler for offering a poor deal to savers past and present. But the regulatory and tax framework set by government must also share the blame. If people are to find a way through the savings jungle, the government must help them, not hinder them.

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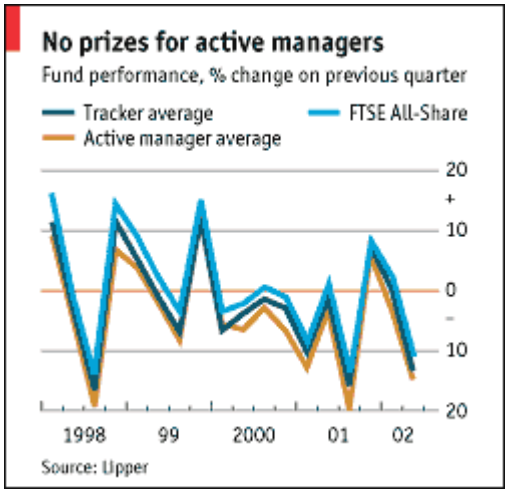
Fund management

Actively cheated

Jul 11th 2002
From The Economist print edition

Retail investors should stay away from actively-managed funds



IN 1999, Kevin James, an American economist seconded to the Financial Services Authority, wrote a scathing report on Britain's fund-management industry. An investor in a typical actively-managed retail fund, he found, would have to put in £1.55 to get a return equivalent to £1 invested directly in the market. The industry got the report held back, and in its published form its language was toned down and its criticisms concealed in technical detail. Now Ron Sandler, who reported this week on the savings industry (see article), has revived much of Mr James's analysis.

Mr Sandler's report points out that the average British unit trust underperformed the equity market by 2.5% a year, because of high charges and poor performance by active managers, meaning fund managers who pick stocks rather than follow an index of companies. Yet retail investors choose to put far more of their money into actively-managed funds—over nine-tenths of it in 2001—than do better-informed institutional investors, who have a quarter of their assets in vehicles that simply track the markets, at a lower cost. Mr Sandler suspects that independent financial advisers, who get more commission selling active funds than passive ones, push their customers into the former.

Active and passive managers have fought for years over which is the better way to invest. In recent times, passive managers have been winning, at least in the world of institutional investors. Compared to an averagely-performing active unit trust, an index-tracking fund is clearly a better deal, because of its lower fees.

There are indeed active managers who outperform for years. “It can be done,” pleads Anthony Bolton, an active manager at Fidelity in London who has frequently beaten the market. But it is hard to predict who will succeed, especially for retail investors. Most fund-management firms bombard them with past-performance numbers, manipulated over particular time periods so that their fund looks like a winner. Past-performance figures are meaningless unless an investor knows what produced the success—it could have been one freak investment in a high-flying technology stock, for instance, rather than a sustainably superior investment process.

Encouraging people into passive funds at the moment could be dangerous, however, because most stockmarkets, which they track, are falling. Although retail investors should put more money into index-trackers relative to active funds, the more pressing decision right now is whether to invest much in stocks at all.

Part of the trouble with active managers is that they are not active enough. As Mr Sandler's report rightly points out, many of them, terrified of underperforming, have hugged indices while still charging high fees. For real active management, investors with enough money—at least £30,000—can choose a hedge fund. These funds, unlike mutual funds, can go short (sell shares they do not own in the hope of buying them later at a lower price) and use borrowed money: they have a better chance of doing well in a bear market. There has been a steady drain of talent from conventional fund management firms into hedge funds, says Bill Muysken, of Mercer Investment Consulting. Until hedge funds lower their minimum requirements, or conventional fund managers are permitted to go short as well as long, small investors will continue to be disadvantaged.

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Academia and politics

Only translate

Jul 11th 2002
From The Economist print edition

A silly self-indulgence with serious implications

BRITISH academics are a disgruntled lot. All that learning doesn't bring them the money they think they deserve; and they have to watch while ignorant politicians make the world a worse place. This sense of impotence perhaps explains why trivial scholastic squabbles excite such vitriol. Occasionally, as in the case of Tom Paulin—who, not content with being a minor esoteric poet and Oxford lecturer, reportedly felt obliged to share his view that Israeli settlers "should be shot"—they get to make little splashes in a bigger pond. A new row about a similar subject, piffling though it seems, raises important questions about the proper relation between academe and politics, and the freedom (or otherwise) of scholarly endeavour.

Some British academics don't like Ariel Sharon. So, with like-minded colleagues in other countries, they have got up a pair of online petitions. One calls for the suspension of European funding for Israeli research; the other declares that its signatories "can no longer in good conscience continue to co-operate with official Israeli institutions, including universities". The signatories include some distinguished British scientists who ought to know better, and several Israelis.

The petitions have excited controversy because of a quixotic interpretation of them by one Mona Baker, a professor of translation studies (of Egyptian descent) at the University of Manchester Institute of Science and Technology. Ms Baker runs two scholarly journals: *Translation Studies Abstracts*, and the *Translator*, whose website avers that it is "not restricted in scope to any particular school of thought or academic group". There is one restriction, however: Israelis aren't welcome. Ms Baker has sacked two Israeli academics from their advisory roles on the journals. Her own boycott has secured her publications (combined circulation: around a 1,000) a profile that, it is fair to say, they may not otherwise have achieved.

Similar petitions have been circulating at American universities—though their dons have also been more vigorous than British ones in defending both Israel and academic freedom. They have organised counter-petitions (such as the one at www.aaisc.net); and Stephen Greenblatt, a bigwig Harvard professor, wrote an open letter to Ms Baker, highlighting the grotesqueness of a journal supposedly concerned with intercultural dialogue adopting her stance. (An Israeli counter-petition points out that some European money is used for collaborative research by Israelis and Palestinians, on such objectionable subjects as desalination.)

Setting aside right and wrong in the Middle East—and the inconsistency of victimising Israeli universities and not those in other abusive states, in the region and elsewhere—this is a benighted strategy. Sanctions, like any other weapon, need to be properly directed if they are to work. For example, the boycott of South African sports teams during apartheid was effective, because the Afrikaners cared about sport. As the spurned Israelis—one of them a former local head of Amnesty International—have pointed out, excommunicating a bunch of (mainly left-wing) academics is unlikely to alarm Mr Sharon. All it does is mock the idea that universities are bastions of sanity and tolerance.

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Selling Britain

The shock of the old

Jul 11th 2002
From The Economist print edition

At last, Britain seems to have given up trying to be hip

High tea for the tourists

BRITONS abroad may be puzzled by the British Tourist Authority's latest advertising campaign. Knights in full suits of armour play tennis in the Welsh marches. Wellies rain down on taxis outside Buckingham Palace. Couples waltz in Trafalgar Square. Faces are uniformly white. The BTA says the £25m sales pitch, which was launched earlier this summer, is already paying off. But whatever happened to the government's mission to rebrand Britain as a modern, multi-ethnic, forward-looking nation?

Not much, it seems. Faced with a 9% drop in visitors in 2001 thanks to foot-and-mouth and September 11th, the BTA fell back on “traditional values and heritage” to flog Britain to the foreigners. Jeremy Brinkworth, its head of campaigns, says the jubilee celebrations have helped to get the message across. Back home, “Cool Britannia”, the catchphrase the government cadged off an ice cream carton, was officially buried last November by Tessa Jowell, the minister for culture, media and sport. “You can't distil our national character to a liking for designer water or retro lamps,” she scoffed.

A case of new Labour, old Britain, then? Not quite. A body called the Britain Abroad Task Force was set up in the wake of the rebranding craze. It still exists; but Jonathan Griffin, its chief executive, says no new money has been found to put any of its proposals into action.

Finding a message around which most Britons can rally is hard; even diversity, the latest buzzword, has its detractors. But branding enthusiasts insist that it's worth trying to change Britain's image. A survey of young opinion-formers in 28 countries, conducted by the British Council during 1999 and 2000, revealed that many still see Britons as weak on creativity and innovation, not to mention class-ridden, racist and cold. That, says Mr Griffin, is bad for trade and bad for Britain's political clout. He would like to run more innovative events abroad, to rival last year's Japan festival in Britain or Italy's staging of “Turandot” in the Forbidden City.

Mark Leonard, whose book “BritainTM” started the branding debate, has a simpler solution. In “Public Diplomacy”, a new pamphlet, he argues that most people get their image of Britain from their national media. There are 1,700 foreign correspondents in London; Mr Leonard claims their reports are dismissed by ministers as “no-votes TV”. Here, he says, is a group that positively wants to be spun at—and for once, no-one is spinning.

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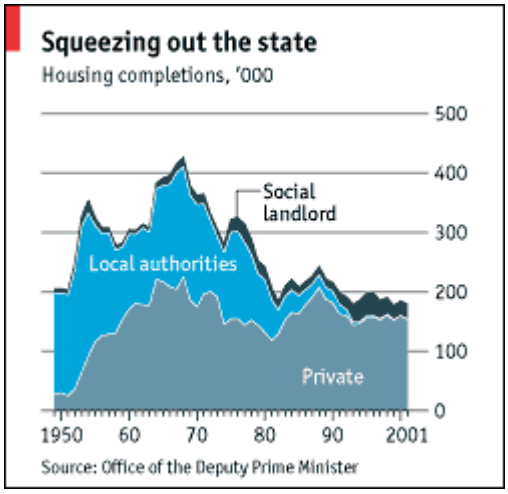
Social housing

Déjà vu

Jul 11th 2002
From The Economist print edition

More social housing is not the solution to the south-east's housing problem



OVER the past 20 years, the proportion of social homes in the total stock has fallen from 31% to 21% and their number has declined from 6.8m to 5.3m. Blame—or credit—Margaret Thatcher for this. Her government forced local authorities to sell homes cheaply to existing tenants and stopped them building new ones. New social homes were to be financed centrally and run by local housing associations.

It now looks like the long squeeze is over. Next week, the government is expected to announce a near-doubling of the Housing Corporation's £1.2 billion annual budget and plans to extend eligibility for social housing. An extra £1 billion would build around 20,000 new homes each year at current rates. This could be stretched further by reducing the amount of subsidy per house.

The government is hoping that this move will help solve its housing difficulties. Thanks to nimbyism, the supply of new houses in Britain falls well short of demand, by more than 50,000 a year according to the Joseph Rowntree Foundation, a social research charity. The result: surging housing costs which have priced modest earners out of the market, particularly in London and the south-east of England. Chief among the victims are public-sector workers, such as nurses and teachers.

The government will try to fulfil its ambitions in part through a phenomenon known as planning gain. Councils are grabbing an increasing share of rising land prices by bumping up the amount of social housing developers must build as part of a new scheme and hand over to the local housing association. Even before the government's fresh money arrives, some local authorities in southern England are relying on planning gain to help meet demanding targets. In plush regency Cheltenham, the council wants 30% of new housing to be social; the figure is 40% in comfortable Poole in Dorset, while the Greater London Authority is targeting 50% in the capital over the next twenty years.

Will this policy just create new ghettos? Maybe not. People have learnt from the mistakes of the post-war housing boom. Providers have got better at design and building. Everybody now knows that concrete blocks do not work in rainy countries. The stigma of social housing can often be eliminated by making it indistinguishable from neighbouring private housing. Social housing developments are even winning awards in competition with private sector developments—the Peabody Trust's Bedzed development in Surrey won the *Evening Standard* Lifestyle Home of the Year award—though it is worth remembering that some of the most notorious 1960s and 1970s council housing estates also won design awards.

Housing associations are generally better at getting repairs done than are councils. They have also been more effective in tackling problems like drugs and prostitution through innovations such as estate offices and on-site caretakers. Above all, planners have learned not to think too big. “No one will ever build a big single tenure estate again,” says Richard McCarthy, Chief Executive of the Peabody Trust.

Yet despite this encouraging news, the central flaw of social housing remains: it discourages mobility. What happens to the teacher who lives in social housing in one borough, and is offered a job in a borough that cannot offer her new cheap housing? What happens to a nurse in cheap housing who wants to move into a new profession? A government so keen on enterprise and initiative should not be recreating a system that makes it difficult for people to change their lives. If public-sector workers cannot afford to live in the south-east of England, then the government should be changing pay scales that

currently discriminate in favour of public sector workers in cheap bits of the country and against those in expensive bits, rather than reintroducing something that once looked like a boon to the poor and turned out to be a shackle.

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Parliament

Blair's poodle bites

Jul 11th 2002
From The Economist print edition

Parliamentary select committees are at last beginning to exercise their muscle

AFTER nearly a quarter of a century dominated by governments with large majorities, Parliament's reputation is at a low ebb. MPs chatter away but nobody pays much attention. Yet those who dismiss Parliament as the prime minister's poodle may have to think again next week.

On July 16th, Tony Blair has agreed to appear before the chairmen of the 35 parliamentary select committees for more than two hours. This is the first time a prime minister has put himself up for such a grilling. For Mr Blair, who speaks and votes less than any of his predecessors, subjecting himself to the scrutiny of parliamentarians is something of a departure. Because MPs will be able to question Mr Blair in detail, these sessions, which will be held twice a year, are potentially much more useful than the weekly histrionics of prime minister's questions.

There are other signs that select committees are beginning to exert greater influence. Robin Cook, the leader of the House of Commons, who has a growing reputation as a reformer, has now given them the lead role in scrutinising draft legislation. A joint committee of both Houses of Parliament has been given the task of coming up with an acceptable reform of the House of Lords. The Public Accounts Committee has finally persuaded government after a decade-long fight that it should be responsible for monitoring quangos' accounts.

The Liaison Committee, which will question Mr Blair next week, is driving change. Its proposal that chairmen of select committees should be paid has been accepted by MPs. So has its recommendation that select committees should be better staffed and be able to draw on specialist skills from a new central parliamentary unit. These reforms arguably represent the most important set of changes to select committees since they were set up 20 years ago to monitor Whitehall departments.

Yet if Parliament is to be an effective watchdog, the issue of resources cannot be dodged. Central government spent nearly £400 billion last year; Parliament spent £7.7m scrutinising government. There are other problems. Select committees cannot claim to be independent if their members are seen to be dancing to the tune of the whips. But MPs recently rejected a proposal that party managers should be forced to relax their grip on nominations to committees. The vote appears even more perverse, now that committee chairmen are to be paid. The result, says Frank Field, Labour MP for Birkenhead, is that the government payroll has been given another “25 nice little earners”.

Select committees also need more power to summon witnesses. The transport committee failed to persuade Lord Birt, the prime minister's adviser on transport, to appear before it to explain his role.

As with any organisation, it's the boss that makes the difference: committees are as good as their chairmen. Gwyneth Dunwoody, who chairs the transport committee, was dubbed “Vinegar Lil” by John Prescott, the deputy prime minister, for accelerating the departure of Stephen Byers, the transport secretary, with a series of acid reports. But other chairmen—in particular, Martin O'Neill (trade), Chris Mullins (home affairs) and Tony Wright (public administration)—have arguably had a greater impact on policy by being a little more positive and a little less rude.

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The north-east

The fall of the Halls

Jul 11th 2002
From The Economist print edition

The turbo-charged rise and decline of a local dynasty

SINCE the 7th century, when Ethelfrith created the kingdom of Northumbria, the north-east of England seems to have been pretty much always in thrall to some powerful local dynasty or other. But while the medieval Percy family or the Victorian Lambtons took several generations to rise and fall, the modern regional potentates follow that arc rather more quickly. Two decades after Sir John Hall earned a fortune by building the MetroCentre shopping complex and seized the regional throne—the chairmanship of Newcastle United football club—the Hall family are having to sell the family jewels.

Des res for sale, several careless owners

On July 9th, Sir John's son and heir Douglas said he was selling Wynyard Hall, the Teesside mansion which his father acquired in 1987. The estate, once the seat of the Marquis of Londonderry, was his father's glory—he revelled in the fact that the son of a humble miner had rescued it from semi-ruin.

Sir John, who has retired to Spain, had a paternalistic devotion to the north-east. He was fond of referring to its people as the “Geordie nation”, had grandiose ambitions of transforming the football club into a glamorous Barcelona-style multi-sports business, and boasted that industrial development at Wynyard would bring at least 10,000 jobs to the region.

Samsung, a Korean electronics firm, did indeed arrive with about 3,000 jobs. But after his son took over running Cameron Hall Developments, the family business, in 1993, things seem to have gone into reverse. Only one other firm has built a factory at Wynyard. Plans for a big development at Doncaster in Yorkshire fell through. Despite an agreement signed with local authorities at Sintra in Portugal, a plan to build a vast holiday theme park has yet to materialise.

Recently, a golf club and much of the Halls' remaining land at Wynyard have been sold off for about £11.5m. If the house and its land fetch the £8m asking price, that is a lot less than the £62m the estate was said in the company accounts to have gained in value since the purchase in 1987. Mr Hall says he is selling because he has bought somewhere closer to Newcastle. The 1999 accounts (accounts for 2000 are ten months late in being published) reveal an alternative explanation. They showed that Cameron Hall had borrowed £40.3m, of which £21.8m was due to be repaid by last November.

The football club is also a much devalued asset, only partly because Mr Hall was videoed in 1998 by the *News of the World* in a Spanish brothel describing Geordie women as “dogs”. Valued at about £200m when it was floated on the stockmarket in 1997, its shares are now only worth about £36m. But even if Mr Hall wanted to sell the 48% owned by himself and some of his family companies, most of the shares are held as security by banks and others who have loaned money to his companies. The message is clear: the north-east crown is up for grabs.

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Bagehot

Are they turning on Tony?

Jul 11th 2002
From The Economist print edition

The middle classes are getting scared. That's when they're dangerous

IT IS almost exactly eight years since Tony Blair became leader of the Labour Party. Within a month of that momentous event, something remarkable had happened. For the first time in polling history, Labour took a decisive lead over the Tories among middle-class voters.

In the 1992 election, MORI, a polling organisation, found that the Conservative lead over Labour among ABC1 voters was 54% to 22%—more or less in line with other elections during the previous 20 years. In the months that followed, the gap narrowed as the Conservatives were increasingly blamed for growing middle-class insecurity. But it was unquestionably the advent of Mr Blair that was responsible for the breakthrough. By the late summer of 1994, ABC1s favoured Labour by 37% to 34%. From that moment, the Tories were on their way out of power.

It has been Mr Blair's extraordinary political achievement to consolidate much of that support over the last five years (one or two blips apart), while at the same time pursuing a moderately redistributionist policy agenda. He has done so in part thanks to the gently rising economy, which has helped to ease a steadily growing tax burden, but mostly because the middle class saw that he was one of them. Although their taxes were going up, they were grateful to Mr Blair for not clobbering them more and were mindful of the need to improve services, such as hospitals and schools, that they used too.

Is all that now changing? Is New Labour's historic *rapprochement* with the middle class coming under real strain as the government's desperation for money to fund its promises grows? If the Tory-supporting *Daily Mail* and *Daily Telegraph* are anything to go by, the answer is unequivocal. They argue that despite its smiley face and commitment not to raise the higher rate of income tax above 40%, the government's true colours become more evident each day with a succession of hammer blows aimed squarely at middle-class values and living standards. They may have the slightly wild glint in their eye of prophets finally vindicated. But these newspapers sense that at long last their readers are becoming angry and they too are naturally angry on their behalf. They also know that convincing the middle classes that Mr Blair has duped them is the essential first stage of any Tory electoral rehabilitation.

And there is indeed mounting evidence that the government is readier than before to take risks with its middle-class support. On July 15th, Gordon Brown will set out his detailed spending plans for the rest of the parliament. These are based on overall expenditure growing by more than 4% a year in real terms. If the economy slows, the implication is that taxes may have to rise by considerably more than the increase in national insurance contributions that the chancellor announced in April.

That will come on top of what looks like a raft of other measures to hit the middle classes where it hurts most. This week, the government came up with proposals to reform the finances of local councils, which, though impenetrably complicated, looked like heralding a big shift of resources from the prosperous shire counties and London boroughs to poorer towns in the midlands and the north. It was also leaked this week that changes in university funding, to be revealed in the autumn, could mean a doubling of tuition fees for most middle-class students to help pay for a return of grants for the less well-off. In a further transfer of money from the children of the middle classes to their needier contemporaries, Mr Brown has indicated that he will pay some sixth-formers an allowance to stay on at school by docking child benefit for 16-to-18-year-olds from better-off families. And so it goes on.

Rumble in the suburbs

Perhaps these will be the straws that finally break the back of middle-class support for New Labour. But

so far, the “stealth taxes” that the Tories lovingly itemise have had surprisingly little effect on the government's popularity. Although nearly 3m people have now been sucked into paying higher-rate income tax, and the government extracts ever larger sums from company car drivers and the booming housing market (thanks to swingeing stamp duty on transactions and an inheritance-tax ceiling that rises with ordinary inflation but not with the bricks and mortar kind), the grumbling is muted. Indeed, MORI's figures for ABC1 voting preference over the first six months of 2002 show almost no change, with Labour averaging just under 40% and the Tories stuck at just over 34%. Not much sign there of middle-class rebellion.

The real situation may, however, be more volatile than the polls yet reveal. If higher taxes don't result in better services, the government will eventually pay a price. But its greatest vulnerability is to events that are beyond its control. A combination of factors contributed to waning middle-class support for the Tories in the early 1990s, but the common theme was a rising sense of insecurity: the housing market bust; the long hangover of negative equity; growing middle-class unemployment caused by the downsizing of corporate bureaucracies and recession in the services-driven south-east; the extensive mis-selling of personal pension schemes—all played their part.

The chancellor may think he has abolished the business cycle and the prime minister may be oblivious (as he demonstrated recently in the House of Commons) to the billions of pounds each week being wiped off the value of pension and insurance funds, but there is again a whiff of real fear in the air. People are getting scared about their dwindling pension prospects and they are increasingly jittery about the growing possibility of another housing market smash and its consequences for the south-east's febrile economy. A grumpy middle class, Mr Blair and Mr Brown can get along with. A frightened middle class is something altogether more dangerous.

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Pharmaceuticals

Mercky prospects

Jul 11th 2002
From The Economist print edition

Why are drug companies finding it so difficult to come up with new blockbusters?

Get article background

THERE was a time when troubled investors could always count on drug makers, not just for their pain-relieving products, but also for their analgesic financial performance. No longer. Since the beginning of the year, pharmaceutical shares have fallen by a third on Wall Street, compared with a drop of a fifth in the S&P 500.

This week brought more bad news, as Merck came under fire for booking $12.4 billion of revenues at its Medco drug-plan unit that it had never collected. Never mind that this accounting trick had no effect on profits. Merck's shares fell slightly; the next day, it dropped Medco's planned $1 billion initial public offering. Meanwhile, the share price of Wyeth (formerly American Home Products) fell by almost a quarter on news that trials of its lucrative hormone-replacement treatments had been stopped because of fears that they do more harm than good. And regulators opened a probe into whether Bristol-Myers Squibb had inflated its revenues by $1 billion last year.

These are not the only bad tidings for the industry. Expiring patents and a rush of generic competitors have eaten into the profitability of some of its most lucrative products, such as Prozac. In America, states and private groups have taken to suing drug makers over excessive profits. And several companies are under investigation by the Federal Trade Commission for anti-competitive practices.

But for all this, the most daunting challenge facing the industry, according to Jean-Pierre Garnier, head of GlaxoSmithKline (GSK), is how to boost productivity in research and development (R&D). For an industry that justifies its high prices and frothy profits on the need to reinvest in R&D, the idea that this engine is running out of steam is particularly worrying.

Recent high-profile product glitches, such as ImClone and Bristol-Myers Squibb's Erbitux, give the impression that the industry is losing its knack for producing wonder drugs. Do the numbers bear this out? According to the Centre for Medicines Research (CMR), an industry think-tank, 31 new drugs were launched on the American market last year, compared with 52 a decade earlier. In order to maintain their profit growth, the giants of the industry need to create roughly three new drugs apiece a year. Since 2000

Pfizer and GSK, two of the largest, have produced three between them in America.

While output stalls, the cost of producing new medicines rises. Last year the industry spent $44 billion on R&D. How well that money has been spent will not be clear for up to a dozen years, the average time it takes to bring a new medicine from a gleam in a scientist's eye to a product on the pharmacy shelf. Analysis from the Tufts Centre for the Study of Drug Development suggests that it now costs an average of $800m to get a drug to market, more than twice as much as in 1987.

Much of this spending goes on clinical trials, the last stage of drug development. A decade ago, testing a drug on 1,000 patients was enough to prove its safety and efficacy. Now regulators demand trials on 4,000 or more patients and a bewildering array of biochemical and clinical tests, all of which add to the expense and duration of a trial.

Banking on blockbusters

End 2001, $bn

	Market capitalisation*	Drug R&D	Present value of drug pipeline
Pfizer	206.7	4.2	37.6
GlaxoSmithKline	126.8	3.8	41.0
Novartis	125.0	1.9	20.6
Merck	103.9	2.3	30.4
AstraZeneca	71.5	2.6	25.1
Roche	56.4	3.2	11.4
Aventis	56.3	2.5	17.6
Eli Lilly	56.2	2.0	29.9
AHP†	49.5	1.6	21.8
Bristol-Myers Squibb	46.0	1.9	30.4
Bayer	23.6	1.3	4.9

*July 9th 2002 †Now called Wyeth

Sources: Lehman Brothers; Thomson Datastream

But according to Martyn Postle, at Cambridge Pharma Consultancy, up to 70% of the high cost of development is eaten up by drugs that do not even make it to market. A rough-and-ready rule of drug-making is that for every 10,000 molecules screened in a given programme in the laboratory, only one will survive to launch.

The most public failures are those drugs that make it into clinical trials, and then stumble. According to the CMR, the success rate of drugs going from large, expensive so-called phase three trials to market has fallen by almost 30% in recent years. Roughly three-fifths of drugs in clinical development falter because of toxic effects, other safety issues or their failure to do what they are supposed to.

In the clinic, companies are trying a variety of tools—such as web-based patient recruitment and data management—to cut time and money from the process. One technique that many are pinning their hopes on to reduce clinical failures is “pharmacogenomics”—using genetic tests to ascertain which patients may or may not respond to a drug. A number of big drug firms are already experimenting with this approach, as are several ambitious biotechnology companies, such as Millennium Pharmaceuticals.

Ideally, though, companies should be catching potential failures and terminating them in the early “discovery” phase, long before they reach patients. This is easier said than done. Many of the trickiest bits of the business—for example, turning a promising chemical into an actual drug—are still as much art as science. Again, new tools are in the works to weed out losers, including fancy computer programs and tissue-sample tests to help predict toxicity, but these are at an early stage. In any case, as Gary Pisano of Harvard Business School points out, the industry has not yet learned to make best use of the tools it already has, such as ways to share information across the various businesses.

To make matters worse, there is still no sure-fire way to predict the nastiest failure of all—the drug that is expected to become a moneyspinner but does not. Stewart Adkins of Lehman Brothers reckons that fewer drugs are making their way from discovery to the clinic, not because they do not work but because their makers fear they may not earn more than $1 billion in peak annual sales—the level above which drugs are considered blockbusters.

Ultimately, pharmaceutical firms are victims of their own success, and the great expectations that accompany this. As Alastair Flanagan of Boston Consulting Group points out, it is not that they have become much worse at delivering new drugs, but rather that they have not become much better. That is exactly what investors hoped for after the last great wave of mergers in the industry, in the late 1990s.

Meanwhile, there are other things that the drug giants can do to boost their productivity, such as licensing drugs from the biotech industry, as Pfizer is busy doing, and overhauling their R&D processes. But it may be years before they reach the magical three new drugs per year. By then they may have taken a very different shape. For some, such as the beleaguered Merck, which has resisted mergers in the past, the overwhelming urge may be to grow bigger still through such unions. But a better approach might be spinning out some or all of their R&D to realise its full value, rather than bolting more on and failing to make it pay.

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Elan

Shame about the name

Jul 11th 2002
From The Economist print edition

Now, cure the balance sheet

FEW parents who christen their children Bella or Felicity believe that their darlings will turn out to be plain or miserable. Until recently, the creators of Elan, an Irish-American drug company, had similarly high hopes that their firm would live up to its name. From modest origins in the low-margin business of drug delivery, only last year Elan looked well on its way to joining the big league. Its market capitalisation peaked at around $20 billion in June 2001.

Today, the firm is worth a mere $600m and faces not only investigation by America's stockmarket watchdog but also a raft of class-action lawsuits from disgruntled investors. On July 9th Elan announced the departure of its chairman and chief executive, Donal Geaney, and reiterated its intention to restructure the group in a bid to restore confidence.

How did Elan go from dash to slash? Most attention has focused on the firm's accounting “irregularities”. In February America's Securities and Exchange Commission announced an inquiry into the way Elan is alleged to have shifted substantial research and development (R&D) costs off its books and into a complex set of joint ventures, while also prematurely claiming revenues from these off-balance-sheet entities, thereby puffing up its profits. This week the SEC sent subpoenas to several investment banks that have had dealings with Elan. The firm's new chairman, Garo Armen, says one of his priorities is to simplify its tortuous balance sheet.

Mr Armen also hopes to raise at least $1 billion in cash over the next nine months. Although he has assured investors that the firm has $1.4 billion to tide it over, investors are still nervous about its liquidity. Elan has already announced that it will close many of its 26 business sites. Ian Sanderson, an analyst with S.G. Cowen, reckons that Elan will give up its rights to some of its bestselling drugs, such as Sonata, for insomnia. The firm has already said it will narrow its R&D focus to such areas as neurology, even though one of its treatments for Alzheimer's disease failed a clinical trial earlier this year.

It remains to be seen whether such moves will shore up investor confidence, or whether the firm (which spent much of the 1990s buying up other companies) eventually becomes prey itself. Like it or not, Elan may yet find itself with a different name.

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Reliance

Dynastic progression

Jul 11th 2002 | DELHI
From The Economist print edition

India's biggest conglomerate loses its founder

EPA

The small investor's hero

MUMBAI'S upmarket Breach Candy hospital had become a place of pilgrimage. Dhirubhai Ambani, the 69-year-old founder of Reliance, India's biggest business group, lay there in a coma for almost two weeks before his death on July 6th. Politicians and businessmen flocked to the hospital to show their respect for the country's most admired (and feared) businessman, and to be photographed by reporters for a story that hogged the headlines for days. On July 7th thousands thronged the streets of Mumbai for his funeral—a sign that Mr Ambani was also held in genuine affection by ordinary Indians, especially small shareholders who saw him as a visionary.

Reliance is a link between two stages of evolution in Indian business. Like many big family-run conglomerates, it prospered by exploiting contacts with politicians and bureaucrats when they controlled most commercial activity. Even after economic liberalisation began in 1991, Reliance's network became ever stronger.

Yet Reliance also did things differently: it built production sites that are globally competitive, and almost single-handedly it popularised share ownership in India. Its two holding companies, Reliance Industries and Reliance Petroleum (soon to be merged), have 3.5m shareholders.

Reliance also differed from India's other dynastic firms in its energy and enterprise. While maintaining family control, it adopted professional management methods, and these brought it successes such as the world's largest greenfield oil refinery at Jamnagar in Gujarat, which started commercial production in 2000.

The son of a poor Gujarati schoolteacher, Mr Ambani began his career 50 years ago at a Shell petrol station in Aden. In his spare time he traded commodities in the souks—at one time melting down Yemeni rials and selling their silver for more than the currency's face value. He returned to India, and in 1959 started a yarn-trading company. By the end of the 1990s he had built an integrated textiles-to-petrochemicals-to-oil empire that then diversified into telecoms, power, financial services and biotechnology. In the year to March 2002, the Reliance group had revenues of $12.2 billion and net profits of $950m.

The successes have been accompanied by controversies—most of which seem conveniently to evaporate before they damage the group permanently. In the 1980s Mr Ambani was accused of using a dummy Isle of Man company to purchase Reliance shares at below market price. In the 1990s there were allegations that the group was issuing and trading fake duplicate shares, some to Mr Ambani's physiotherapist. More recently, three senior executives were charged with possessing sensitive government papers on privatisation. But this did not stop Mr Ambani from being regarded as a hero by small investors, perhaps because other owner-managers treated them worse.

Nowadays, however, Reliance no longer automatically gets its way with the government. It recently failed to win privatisation bids for two big state-owned companies, and it had to overcome loud public opposition—and pay substantially more than other bidders—to buy a state-run petrochemicals firm, IPCL, in May. Its plans to offer a full range of telecoms services are dogged by court action; big cellular operators, such as AT&T and Hutchison Whampoa, have challenged a ruling that helps Reliance expand

at their expense.

Such challenges are inevitable as India becomes more open and more transparent. Dealing with them will be the job of Mr Ambani's two sons—Mukesh, 45, who runs the main businesses and is expected to become group chairman, and Anil, 43, who specialises in finance and external relations. Both have MBAs from top American schools and have managed the company increasingly since their father had his first stroke in 1986. But Mr Ambani senior remained a power, advising his sons at thrice-weekly lunch meetings and, it is said, bridging differences between them. They will miss his counsel; it will soon become clear how they manage without it.

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European companies

Not so different after all

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European firms are almost as troubled as their transatlantic counterparts

WITH so many American companies facing embarrassments, it ought to be a good time for Europe to promote its gentler model of capitalism. After all, continental firms have been slower to embrace the brash excesses—from stock options to fraudulent accounting—that now dog their American rivals. Often criticised in recent years for being old-fashioned and rigid, surely Europe's breed of capitalism is now proving its superiority?

Alas, a slew of companies is busily making the opposite case. Europe's corporate culture is serving shareholders and owners with no more distinction than its short-termist American counterpart. Nor is the continent free of accounting scandals. Indeed, it appears simply to be behind America in bringing them to light. In the clash of capitalist systems, Europe's armoury is weaker than might be expected.

Consider, for example, Vivendi Universal, a French-based media, telecoms and water group that has flirted with bankruptcy in recent weeks. For many Europeans, Vivendi has stumbled in part because it became too American. Jean-Marie Messier, its colourful former boss, embraced American-style deal-making and managerial incentives. He even left Paris to be based in New York.

But the real roots of Vivendi's troubles are financial. After parting company with Mr Messier on July 3rd, the company confirmed that it was facing a liquidity crunch. In classic European style, on July 9th it secured from its banks a new short-term credit line that should see it through the next few months. But no sooner had the ink on that agreement dried than the French stock exchange was raiding its offices as part of a probe into the group's financial disclosures since January 2001. It remains to be seen whether an accounting fraud will be uncovered, but at a minimum Mr Messier and his team seem to have misled the markets as to Vivendi's true financial position. Parallels are already being drawn with WorldCom, an American telecoms company that is being investigated for a $3.8 billion accounting fiddle.

Vivendi is not alone in carrying a whiff of impropriety. On July 9th it emerged that ABB, a once admired but now troubled Swiss-Swedish engineering group, had uncovered a fraud affecting its 1999 and 2000 numbers. Because its internal auditors picked up the fraud, for which several London-based managers have been dismissed, ABB did not have to restate its accounts. But the embarrasing episode has weighed on the firm's shares.

ABB is part of an industrial empire built by Sweden's Wallenberg family, and a good example of the continental tradition of benign, concentrated ownership, which contrasts with America's (and Britain's) capital-market-based, dispersed ownership model. Too benign, perhaps, because it is now clear that ABB's managers did a dreadful job of protecting their owners' assets. The same is true of Italy's Fiat, a group owned by the Agnelli family, which is also struggling with heavy debts and poor day-to-day performance, notably in its car-making business.

Europe can be prouder of its growing unwillingness to bail out corporate basket cases. On July 8th Babcock Borsig, a German engineering company, went bust after it failed to persuade its banks to prop it up (see article). That said, plenty of big, ailing companies are still being kept alive through old-style, bank-led rescues. Not for some years have the continent's commercial banks wielded so much power.

Where banks hang back, Europe's governments still cannot resist the temptation to meddle. Fiat has been offered help by the Italian government. France Telecom and Deutsche Telekom have mountains of debt and feeble share prices, but are protected by implicit state support. The French government has done little to quash rumours that it will bail out France Telecom. Top managers of both companies have presided over highly priced misadventures, but have been shielded by their political masters. Ron

Sommer, Deutsche Telekom's boss, could yet be toppled. As *The Economist* went to press, the German government seemed to be pressing him to go.

Other telecoms companies have problems that point to broader European challenges. On July 9th, for instance, it emerged that Spain's Telefonica had restated its *euro*2.1 billion ($1.9 billion) net profit for 2001 to a *euro*7.2 billion loss. It did so because its shares are listed in New York as well as Madrid. This requires it to report under two quite different accounting regimes. Under American rules, goodwill arising from acquisitions cannot be depreciated over 20 years, as Spanish rules allow. DaimlerChrysler, a German-American car maker, frequently causes confusion because it reports under both accounting standards. Shares in Ahold, a Dutch supermarket operator with large American operations, recently tumbled after investors took fright at the company's attempt to gloss over an unflattering American accounting treatment in favour of the European one.

Jumpy investors are quick to assume the worst at present, partly thanks to this confusion among accounting systems. The rash of scandals on Wall Street has shattered the notion that American rules are better. But Europe's own troubles are undermining any sense of *Schadenfreude*. For those who have long argued that European capitalism has plenty to offer, it is an opportunity missed.

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German corporate failures

Sunken treasure

Jul 11th 2002
From The Economist print edition

Babcock Borsig joins the long list of German firms to go bust this year

IN 1996 German banks extended DM600m ($400m) to save Babcock Borsig, a century-old engineering titan of the Ruhr Valley. Now the banks are in a less charitable mood. Despite government promises of aid, they refused this week to contribute to an *euro*800m ($790m) rescue of Babcock, prompting the firm to go bust. Commerzbank, one of the leading lenders, brusquely noted that Babcock was no longer "capable" or "worthy" of being restructured. What has caused the banks' mood to sour?

For one, Babcock's financial health had deteriorated fast. Last year Klaus Lederer, Babcock's boss at the time, said he would consider selling the firm's power-plant construction business and concentrate on the more lucrative business of building submarines. The plan was to buy out the 50% of HDW, a submarine maker, that Babcock did not already own. Earlier this year, however, Mr Lederer abruptly changed course and sold half of the HDW stake to One Equity Partners, part of Chicago-based Bank One. Investors were appalled, and Babcock's shares fell to a ten-year low. Mr Lederer appeared unscathed: in a curious move, One Equity appointed him head of HDW in March.

In the past, Germany's banks would have rushed to prop up a big corporate name such as Babcock, whatever its state. But now, with several German heavyweights having already gone bust this year, including Philipp Holzmann, a building firm, and Kirch, a media giant (see table), lenders can no longer afford to support no-hopers, even those that employ tens of thousands. The banks have watched their bad debts accumulate and their share prices fall, driven down partly by investor perceptions that they are too political, says Marijn Smit of ABN Amro.

Big busts
German bankruptcies, selected, 2002 to date

Company	Sector	Employees affected*
Babcock Borsig	Engineering	11,500
Kirch†	Media	10,000
Mühl	Construction services	3,800
Fairchild Dornier	Aerospace	3,600
Philipp Holzmann	Construction	3,200
Herlitz	Paper and stationery	1,900
Sachsenring	Vehicle parts	1,300
Cargolifter	Zeppelins	500

*In Germany
†Various subsidiaries, incl. KirchMedia and KirchPayTV
Sources: *Handelsblatt*; Creditreform; press reports

Babcock's bankruptcy comes at an awful time for Gerhard Schröder, Germany's chancellor, who is trailing his conservative rival, Edmund Stoiber, in the run-up to September's presidential election. Around 11,500 Babcock jobs are at stake in Germany alone, and this week the Bundesbank reported that unemployment had risen to 9.8% in June, the highest in almost three years, while industrial production dropped. The number of German companies filing for insolvency rose by 14% last year to 32,278. This year the number is sure to be considerably higher.

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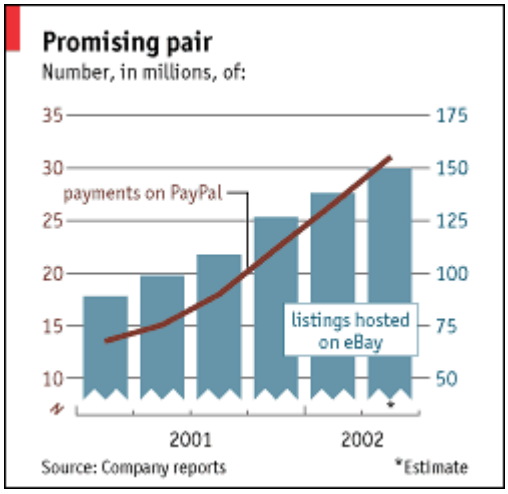
Internet firms

Be my PayPal

Jul 11th 2002 | NEW YORK
From The Economist print edition

Buying PayPal makes sense for eBay, but it comes with legal risks



THE real surprise is that it took so long. For months, rumours had been circulating on Wall Street that eBay, the leading online-auction service, would buy PayPal, the dominant provider of Internet payments. When the takeover was finally announced on July 8th the terms, too, were much as expected. The all-share transaction values PayPal at $1.5 billion, slightly above the firm's average market capitalisation in recent weeks.

The acquisition was predictable because the two companies are not only complementary, but depend on each other. EBay is the most successful surviving dotcom. It is even making money. The firm said on July 8th that second-quarter net profit would be $54.3m on revenue of $266m, an increase of 121% and 47% respectively on the same period last year. But for all its success, eBay has been slow to provide buyers with an easy and cheap way to pay sellers online.

This is where PayPal has excelled. Its users hold an account backed by a credit card or a bank account. They send money by simply typing in an e-mail address and an amount. Launched in October 1999, the service quickly became the payment scheme of choice on eBay; auctions still account for about 61% of PayPal's business. As of March, 12.2m consumers had signed up to use PayPal, but it is the 3.2m fee-paying business-account holders who make the firm profitable: it is expected to report net profit of about $5.5m on revenues of $54m for the second quarter.

PayPal's and eBay's business models are similar. EBay, which started out as a marketplace for collectibles, quickly entered a virtuous circle in which more buyers attracted more sellers, who attracted yet more buyers and sellers. PayPal also took advantage of such “network effects”. To reach critical mass, it initially paid users $10 to sign up their friends—an incentive it was soon able to drop. The firm is now signing up about 28,000 new users a day.

These network effects could start to cause problems, however, if they turn a combined eBay and PayPal into an e-commerce giant with which it is hard to compete. Although eBay does not expect antitrust enforcers to stop the deal, it is bound to face scrutiny in the future. The Department of Justice has already taken a close look at the firm once, although it recently ended its inquiry. Just as worryingly for eBay, its members might not appreciate having to depend on the same firm for both online auctions and payment.

The acquisition of PayPal brings other risks for eBay. Chief among them is the possibility that the firm will be regulated as a bank, which would be costly. The New York Banking Department recently concluded that PayPal is not engaged in banking, but other states may yet decide differently. Furthermore, as PayPal grows internationally, foreign regulators will show more interest. The service already allows users in 37 countries to buy and sell in dollars. On top of this, PayPal faces a number of private legal challenges: three firms are claiming that the service infringes their patents, and disgruntled users have launched four class-action suits.

Despite all this, eBay's takeover of PayPal could encourage other dotcoms to make deals. One rumour doing the rounds in Silicon Valley is that Yahoo!, the leading web portal, is keen to buy Google, a popular search service. Whether the deal will actually happen depends on which venture capitalist you ask. Some

say it is only a question of price, others that Google is in it for the long run. But that is just what PayPal executives were saying until recently.

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Steel

Brazil, where the slabs come from

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Corus's planned link-up with CSN reflects a shift in industry thinking

IT DID not exactly get a welcome in the hillsides. On July 5th Corus, an Anglo-Dutch steel maker, closed its Ebbw Vale plant in the South Wales valleys, ending more than 200 years of iron and steel making there. Only the previous day, the firm had confirmed that it was in talks with CSN, Brazil's largest steel maker, about some sort of link-up. This prompted fears of further closures, since CSN's production costs are far lower than those of Corus (the fusion of British Steel and Hoogovens of the Netherlands). As some of its rivals in America and elsewhere are doing, Corus may move towards buying its steel ready-made in big slabs from Brazil and concentrating on the business of rolling, bashing and chopping it into final products.

Corus is the world's sixth-largest steel maker, producing 18m tonnes a year, three times CSN's capacity. But besides having high production costs, it worries that supplies of its main raw material, iron ore, are becoming concentrated in the hands of a few giant mining groups. CSN is thus an especially attractive partner because, besides being a cheap producer, it has its own iron-ore mine.

Brazil's huge iron-ore reserves and the efficiency of its steel makers mean it can turn out steel slab at around $100 a tonne, less than half what it costs to make in America, says David Phelps, president of the American Institute for International Steel. Since America's blast furnaces are ageing and expensive to rebuild, some of its biggest steel firms, such as AK Steel and California Steel Industries (CSI), are resorting to importing Brazilian slabs. While other producers earlier this year pressed President George Bush to impose tariffs of up to 30% on many foreign steel products, these firms successfully lobbied Mr Bush to exempt Brazilian slabs by giving them a generous low-tariff import quota.

Other countries, such as South Africa and India, which have lots of iron ore and a local steel industry, could eventually follow Brazil and become big exporters of cheap steel slabs for companies in consumer countries to bash into shape, says Tom Meyer, a steel analyst at UBS Warburg. But they have less chance of becoming big exporters of finished products, because the end users, such as car makers, may prefer having their sheets, plates and tubes knocked up locally, thus making it easier to change specifications rapidly, and reducing the need to keep big stockpiles in case of shipping delays. Moreover, low-cost producers have a better chance of avoiding rich-world trade barriers with raw slabs than with finished products.

If its deal with CSN goes through, Corus will not be the first rich-country steel maker to take a direct stake in Brazil's competitive slab producers. CSI and Arcelor, the world's largest producer, based in Luxembourg, own a combined 46% of CST, which is CSN's biggest local rival. And this week it was announced that Dongkuk, a South Korean steel maker, had agreed with CVRD, Brazil's giant iron-ore miner, and other investors to develop a new slab plant on Brazil's north-east coast.

Until it started talking to Corus, CSN, like Gerdau, another Brazilian steel firm, had been heading in the opposite direction, and buying mills in America so it could send its steel to them for finishing. The future of this strategy is not clear, though CSN's American mills could be a route for Corus to increase its tiny market share there. A deal should help CSN to boost its foreign sales, which are still less than 20% of the

total. More foreign earnings and the backing of a big foreign shareholder would make investors rate CSN more highly. That would cut its borrowing costs, especially if, as is reported, Corus plans to take some of CSN's debts on to its books. In difficult times like these, such an offer is hard to refuse.

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Face value

His high-tech Highness

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Barry Lam, boss of the world's biggest laptop maker, fancies his chances in storage and artificial intelligence

HOW best to describe Barry Lam, the founder, chairman and chief executive of Quanta Computer, the world's largest maker of laptop computers? “Confident,” says an acquaintance at Taiwan's trade-development organisation, with a smirk that implies understatement.

And yet Mr Lam is hardly a household name. If you have not heard of him or of Quanta, that is because it suits him commercially to keep a low profile. If you own a Dell laptop, there is a better-than-evens chance that it was made in Quanta's factory near Taipei's airport. If you have an IBM, Apple, Compaq—in fact, any big brand except Toshiba—there's a fighting chance that it was made only metres away under the same roof. Quanta, in other words, is a contract manufacturer—a company that designs and makes gadgets but leaves the marketing (and increasingly only that) to companies with famous brands. And those brand-owners, naturally, like to hog the limelight. “Our customers don't like us on front pages,” says Mr Lam.

That has not prevented him from gracing several already. Indeed, despite claiming to be happy lurking in the background, his views and his record invite attention. In the 1970s he founded a company called Kimpo, which became the world's largest contract manufacturer of calculators. In the 1980s, he claims, he was the first to dream of portable PCs, and only by founding Quanta in 1988 did he enable the likes of Dell to become successful. “In 1980 I became king of the calculator,” he boasts. In 2000, when Quanta passed Toshiba as the world's leading maker of portable PCs, “I was king of the laptop.”

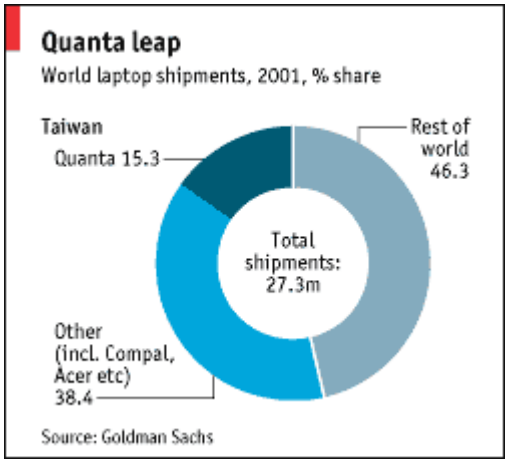
Mr Lam's self-belief stretches into the future, too. He predicts that he will be the undisputed king of data-storage servers within five years. And further down the road? Wireless gadgets interest him, as does artificial intelligence.

Such bravado seems surprising at first glance. Mr Lam is small, with a tendency to slouch and twitch. He usually dresses less like a typical businessman than like a creative type from the avant-garde theatre company that he sponsors, or a painter of the Chinese pictures that he avidly collects. (He reckons that he is among Christie's best clients in Hong Kong.)

Yet the mettle, even if hidden, is still there. Although he made his name in Taiwan, Mr Lam originally hails from Hong Kong, whose people the Taiwanese credit with superior street wisdom. Among Mr Lam's nicknames is “*hei shou*”—a “black hand” who knows how to pull strings. He tends to get good deals and to brag about them. He hints at, but is reluctant to elaborate on, close relations with key officials in China, including the mayor of Shanghai, Mr Lam's place of birth and the location of one of Quanta's newest factories.

To be sure, Mr Lam has a lot to be proud of. The story of his company is in many ways synonymous with Taiwan's stunning rise as contract manufacturer to the world. In laptops, for instance, Taiwanese companies (albeit increasingly, in Chinese factories) had 54% of the world market last year (see chart); this year their share is expected to rise above 75%. Quanta is by far the largest of them, with more than 15% of total world shipments.

The company also has one of the most promising business models in its industry. Contract manufacturers tend to be either providers of so-called electronic manufacturing services (EMS) or original design manufacturers (ODMs). The former simply build machines designed by other companies. This makes economic sense, because aggregating several companies' orders allows EMS firms to achieve greater economies of scale and lower risk than their customers could ever do.



On the other hand, as their customers merge (Compaq and HP, say) and become more powerful, EMS margins are shrinking. By contrast, ODMs such as Quanta invest in research, and design machines as well as making them, so they can command a premium for their services. That does not shield them from margin pressure as the industry matures. But Quanta, for one, was rare in keeping its gross profit margin above 10% even during last year's downturn.

Nonetheless, laptop manufacturing is rapidly becoming a mature, low-margin industry, just as the making of desktop computers has done. The kingdom, in other words, will soon start shrinking, which explains why Mr Lam now covets new realms. His latest target, storage systems, makes some sense. Most people accept that computing power and storage are moving away from desktop and laptop computers, and on to servers stacked in back rooms. Profit margins on these powerful computers, while shrinking, are higher than on desktops and laptops.

Worth conquering?

The problem is that servers are different from calculators and laptops. The end user is not the consumer but a big, brawny company. That makes marketing and branding a different game, and hence diminishes the logic of a division of labour such as that between Dell and Quanta. Piling it high and selling it cheap, the contract manufacturer's forte, works better for PCs than for powerful computers that are a critical part of companies' infrastructure—and for which companies are thus willing to pay a premium. In short, it is by no means clear that there will be any successful contract manufacturers of servers for long, even if Quanta were king among them.

Wireless gadgets, the second realm in Mr Lam's sights, are consumer products. But here the problem is that much depends on the uncertainties of consumer demand for third-generation (3G) technology. Even if take-up is good, the queue of competitors is already long. As for artificial intelligence, Mr Lam's third target, this industry remains speculative, and is unlikely to produce much by way of profit in the near future. Even the king of the laptop may thus find it hard to conquer new territories.

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Bank reform in Japan

Hampered

Jul 11th 2002 | TOKYO
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A reshuffle at the Financial Services Agency, and an opportunity missed

Get article background

SO MUCH for the government's promises to clean up Japan's banks, which are weighed down with ¥150 trillion ($1.3 trillion) of bad debts. Since 1998, when a supervisory agency and a special commission were created, precursors to today's Financial Services Agency (FSA), there has been much talk but little action. An injection of public funds in 1999 turned out to be just a temporary rescue of the banks and their worst borrowers. Though Junichiro Koizumi made fresh promises when he became prime minister in April 2001, he has yet to deliver.

As reforms have stalled, so banks have weakened. Not counting public money and taxes that have been deferred, the big banks' capital is derisory: equivalent to barely 2% of their assets, a mere quarter of the minimum that international rules require. Banks are reluctant to take risks, so they have cut lending for each of the past four years, a drag on the economy. All the while, the two top men at the FSA, Hakuo Yanagisawa, the financial-affairs minister, and Shoji Mori, its bureaucratic head, have continued to insist that the banks are fine. The two are widely blamed for the lack of progress.

The prime minister missed a chance with his appointment of Shokichi Takagi as the FSA's new leader when Mr Mori steps down on July 12th. The announcement was a surprise, since the head of planning at the agency, Tsunekazu Haraguchi, was generally expected to win the top spot. Mr Takagi's promotion—he used to head the FSA's supervisory division and is a close ally of Mr Mori—has delighted Mr Yanagisawa and the old guard within the ruling Liberal Democratic Party (LDP). It has dismayed reformers, who had hoped that policy would shift from propping banks up to cleaning them out.

Not that Mr Haraguchi was likely to prescribe harsh medicine for the banks, either. Yet he did at least listen to the lower ranks, where reformers are plenty; and he would probably have diligently carried out any orders for reform that he might have received from above. He appears to have distanced himself from some of the more blatant fiddling that took place on Mr Mori's watch: propping up the stockmarket by changing short-selling rules, for instance, and persuading banks to bail out Daiei, a supermarket chain with over ¥2 trillion of debts that was ripe for bankruptcy. That may have cost Mr Haraguchi the top job.

At first, Mr Koizumi asked Mr Yanagisawa to come up with candidates from the private sector, but was overruled by his minister. Mr Koizumi could also have chosen Hirofumi Gomi, a tough reformer who headed the agency's inspection division: he was the only candidate with real experience of regulating banks. Some still hope that Mr Gomi will overhaul the supervisory division he now heads, as he did the

inspection division.

Still, not much can change until Mr Yanagisawa does, or until he is replaced. Some in the cabinet are critical of Mr Yanagisawa's foot-dragging. Mr Koizumi himself shows little interest in banking matters and until now has been content to follow his minister's advice. There is talk of a cabinet reshuffle, but few expect Mr Yanagisawa to go.

Mr Yanagisawa is slowing down reform, but the conservative bits of the LDP want to reverse it. They are urging the government to postpone (again) the second stage of deposit-insurance reform, when government guarantees are to be lifted next April on deposits of over ¥10m. (In the first stage, last April, guarantees on long-term deposits were lifted.) Mr Yanagisawa opposes the idea, which he insists is unnecessary since banks are healthy. But parliamentarians are pushing to get a bill of their own through in the autumn. They are concerned that weak regional banks and credit unions, which are already losing deposits, could suffer full-blown runs as the deadline nears. The bill will face at least some resistance from within the party. One LDP politician, Ichizo Ohara, fears that pushing back deposit-insurance reform will take away the incentive for banks to restructure and merge.

Consolidation among Japan's 100-odd banks (not counting the many credit unions) is badly needed. Weaker banks should go bust, then be wound up or sold to stronger institutions, including foreign bidders. New proposals unveiled on July 10th by the FSA offer tax breaks, higher caps on deposit insurance and public funds—all in the hope of promoting mergers of regional banks. Still, these measures smack of a rescue of weak regional banks, artificially prolonging their life. They would do little to make the industry any more efficient, says Hironari Nozaki, a bank analyst at HSBC Securities.

Ironically, the government's failure to restore public confidence in banks may be good news for its own postal savings system, which, as the world's biggest financial institution, controls about a third of the savings market and is badly in need of reform. The deposits and insurance premiums that the post office collects are spent on wasteful public-works projects—such as bridges that nobody uses—or on propping up stockmarkets. At least Japanese banks channel money into enterprise, even if they do not do it very well.

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Mortgages in Japan

New loans for old

Jul 11th 2002 | TOKYO
From The Economist print edition

All is not what it seems

IS THERE really a boom in home loans in Japan, as some commentators are now starting to claim? In May housing starts rose by 5.8% year-on-year. Demand for flats in urban areas such as Tokyo and Osaka is solid. Land prices have fallen by half over the past decade, and now Japan's ultra-low interest rates are persuading growing numbers of young people to buy rather than rent. Figures from the Bank of Japan show that mortgage lending by private-sector financial institutions rose by 4.3% in the year to March 31st, and by 2.5% the year before—astounding growth by recent Japanese standards.

Look closer, though: the broader numbers from the Bank of Japan fail to support the notion of a boom. Its snapshot of the country's financial assets and liabilities, released quarterly, shows total housing loans to individuals, made by both public and private mortgage lenders, rising by just 1.3% in the year to March, less than the 1.8% increase the year before. People are replacing their mortgages held by the Housing Loan Corporation, the state lender, with mortgages from banks—leading to a 3% fall in public lending. This is happening largely because they are refinancing loans made when interest rates were higher. Since the state lender accepts applications only for new mortgages, banks have picked up the business.

It also helps that the Housing Loan Corporation, which by 2005 will be wound up and turned into a supposedly independent agency (which may or may not continue making housing loans), is lowering lending limits and tightening restrictions. This cheers banks, which have found it hard to compete with a government-owned entity that can undercut rates and has quirky criteria for accepting mortgage applications. Banks consider a borrower's ability to repay mortgages. The Housing Loan Corporation, set up in 1950 to provide citizens with better housing, give such matters only a cursory glance: its lending decisions are based on the quality of the building. Its default ratio of 0.7%, though low, is still four times that of the banks, a measure of how much easier it is to get housing loans from the state.

Still, banks are redoubling their efforts. Sumitomo Mitsui Bank now offers a product, limited to new housing, which offers cheap ten-year mortgages with fixed rates; other banks have similar bargains. Banks are keen on housing loans because home-owners are less likely than corporate borrowers to default. Besides, they need to increase lending, their main business, which has been contracting for 54 months in a row.

Overall, however, the outlook for the mortgage market is not bright. Though property prices have been falling, few believe they have yet bottomed out. Despite the rise in housing starts, which may be a small correction after two months of falls, housing investment is expected to remain weak. True, big cities have enjoyed rising demand. Yet Japan still suffers from a housing glut. That means Tokyo's gains have been matched by falling demand in neighbouring suburbs, says Toshihiko Okino, a construction analyst at UBS Warburg. Demand from young people has increased only from a very small base. Older folk, who generate the bulk of demand, are too concerned about a sputtering economy, rising unemployment and falling wages to want to take on big new liabilities for a while yet.

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Contrarian investors

A long-distance call

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Three smart investors dip their toes into telecoms

AP

Buffett: has this cat got the cream again?

FOR American investors, the telecoms sector has been a spectacular disaster. Over the past two years, more than 50 telecoms companies have defaulted on $70 billion of debt, according to Moody's, a ratings agency. Dozens more companies teeter on the brink of collapse, while the share prices of even solvent companies have fallen by more than nine-tenths. Were all the losses added together for every share, derivatives contract and loan, then the only comparable destruction of value must have been that which accompanied the building of the railroads in the 19th century, the last great privately financed construction project. So is now the time to buy?

This week Warren Buffett of Berkshire Hathaway, who consistently questioned the technology bubble as it inflated, put $100m of Berkshire's money into a $500m pool, along with two other companies that reputedly rarely overpay, Legg Mason and Longleaf Partners. The money will be invested in Level 3 Communications, a company that shares many of the worst characteristics of the beleaguered industry. It is in a business—long-distance telephony—with huge overcapacity and commodity-like returns. It has a large pile of debt, serviced by a trickle of cash.

Level 3 says it will use the money to make acquisitions of companies in the same business, mopping up all that excess capacity. Wall Street analysts, however, are quick to point out that, until now, Level 3 has had a puzzling strategy when it came to acquisitions. In the past year the company has spent $200m buying two software-distribution companies, at least in part, the analysts say, to satisfy demands from bank lenders that the company meet certain revenue targets. That raises doubts about Level 3's consistency of purpose. Yet these new investors are far from naive. Their collective presence suggests, at the least, that they think that Level 3's accounting methods are sounder than those of Global Crossing, Qwest, and WorldCom, three troubled competitors.

Mr Buffett may also have been reassured by Level 3's roots. Berkshire Hathaway's headquarters are in the same building in Omaha, Nebraska as those of Kiewit, a construction company that created Level 3. What is more, Level 3's chairman, Walter Scott, is on Berkshire's board. Admittedly, $100m is no large bet for Mr Buffett. At the end of March, Berkshire Hathaway had $7.4 billion on its balance sheet.

Buying assets for pennies on the dollar is tempting for any investor concerned, as these three groups are, more with good value than with high growth. Even so, no benchmark exists for valuing long-distance lines. In May, Hutchison Whampoa from Hong Kong offered to buy the telecoms assets of Global Crossing, which is bankrupt, for 5% of their value as recorded on Global Crossing's balance sheet. The offer was deemed too low, and new bids will be collected this week, to be announced at the end of the month.

In the case of Level 3, in return for their $500m, Mr Buffett and his partners will receive new subordinated debt paying annual interest of 9%, about half what the company's $5 billion of outstanding bonds return at secondary-market prices. The debt may be converted into equity at $3.41 a share, around what the company's shares were trading at just before the infusion of new money was announced.

To make money from such a deal will require a substantial recovery. Level 3's bank and bond obligations

trade for less than 50 cents on the dollar, and these must return to full value before Mr Buffett's security has any intrinsic worth. So his investment is a small bet on a massive rebound. This could play out in several ways.

The most direct way would be for Level 3 to face little competition in buying up distressed, long-distance assets. That might be the case if antitrust barriers to entry remain for America's surviving Baby Bells—Verizon, SBC and Bell South, all short-distance companies.

Alternatively, if the barriers were to be pulled down, in response to the collapse of the long-distance companies, then Level 3 might itself be acquired by a Baby Bell. In other words, Mr Buffett's investment is like buying a lottery ticket when the prize pool is attractively large. There is a not-impossible shot at a huge return. But there is also a good chance that the ticket, in the end, will prove worthless.

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Canada's securities markets

Thirteen into one won't go

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Streamlining capital markets, up to a point

FOR more than 20 years, Canada's bankers, lawyers and money managers have been trying to persuade politicians that 13 different securities regulators are 12 too many. Their message has fallen mostly on deaf ears, but that has not stopped them from trying—this time with more gusto than ever.

Because securities law falls under the provinces' jurisdiction, each of the ten provinces and three federally administered territories has its own rules, plus a regulator to enforce them. Companies wanting to sell securities to investors across the country require permission from all 13 jurisdictions. Horror stories abound. Shoppers Drug Mart, a pharmacy chain from Toronto, made the mistake last autumn of trying to clear a final prospectus for its initial public offering on Remembrance Day, only to discover that nine of the 13 regulators were closed. British Columbia's securities commissioner was persuaded to give his approval from home over the telephone.

Mark DesLauriers, a partner at Osler, Hoskin & Harcourt, a Toronto law firm, says the frustrations are especially acute in licensing investment advisers, mutual-fund managers and other market participants; and for private placements, where three of the biggest provinces, Ontario, Alberta and British Columbia, have recently adopted differing rules. Estimates put the cost of regulation in Canada at about the same as Britain—with its far bigger markets—and more than double the cost in Australia. Almost 3,800 people do the job in Canada, compared with under 2,800 in Britain and 2,200 in Australia—neither of which has a notably lean regulatory apparatus for securities.

Regional jealousies are part of the problem. Alberta maintains that it needs special rules to grease the wheels of investment in its oil and gas industry. Ditto, mining and venture capital in British Columbia. The chances are less than slight of Quebec signing on to a pan-Canadian agency, so long as a separatist government remains in office.

The provinces are also loth to sacrifice a tidy source of revenue. In New Brunswick, where the securities commission functions as a branch of the justice department, fees brought in C$5.1m ($3.3m) last year, nicely covering the cost of the seven-person operation. Fees paid to the four biggest commissions in Ontario, Quebec, British Columbia and Alberta jumped by two-fifths between 1997 and 2000, to C$157m.

Some progress has been made towards harmonising the rules. Since 1997, companies have been able to file regulatory documents through a single electronic system, known as Sedar. A series of national instruments have codified rules for prospectus disclosure, mutual-fund regulations and early-warning requirements. Doug Hyndman, chairman of British Columbia's securities commission in Vancouver, has proposed cutting red tape by, for instance, replacing prospectuses with a continuous disclosure system that allows public companies quick access to markets.

Still, a review of Ontario's securities laws concluded earlier this summer that the creation of a single regulator is the most pressing securities issue in Canada. The lobbying campaign has intensified in recent weeks. Barbara Stymiest, head of the Toronto Stock Exchange, has asked the provincial premiers to put securities regulation on the agenda at their annual meeting at the end of July. A small group of business leaders in each province is taking up the cudgels informally with politicians. Before he was fired as the country's finance minister last month, Paul Martin spoke out in public about the costs and inefficiencies of

the present system.

A better one, with a chance of coming into being, would involve more harmonisation and a European-style passport system—where each province recognises decisions made by the others. Certainly, an improvement on the present mess.

Best of all would be a national securities commission. The odds of that—even without Quebec—are not good. Purdy Crawford, a businessman who chaired the recent Ontario review, says that no agreement is likely unless Ontario, home of the Toronto exchange and the bulk of the financial-services industry, agrees graciously to accept equality with the smaller provinces. Dream on.

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Cocoa

Bouncing beans

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Are evil traders conspiring to raise the price of treats?

IF YOU lost money from falling share prices, take heart: there may be time to ride the cocoa bull market. Cocoa prices have shot up by 125% since the beginning of 2001, to a 15-year high (see chart), even as coffee trades at a nine-year low. Some traders on London's cocoa exchange suspect shenanigans: namely, somebody trying to corner the market.

Prices for cocoa, like other “soft” commodities such as coffee, had been grinding generally downwards for over a decade—a far cry from the highs of the 1970s and 1980s. As the price sank, so cocoa became a favourite target of the anti-globalisation camp. The call went out for a consumer boycott, since low cocoa prices were deemed to encourage the use of slave labour in producing countries, notably in Côte d'Ivoire, which accounts for two-fifths of the world supply. Anti-globalisers lament the collapse of commodity boards, cartel-like bodies that aimed to do for cocoa, coffee and the like what OPEC does for oil. Most have long been abandoned, and recent attempts to reconstitute them have failed.

Why the recent sharp rise in prices, then? A poor cocoa crop is one reason, political instability in Côte d'Ivoire another. But a third, commodities traders in London are convinced, is that somebody is trying to corner the market.

Cornering any commodity is no easy business, and cocoa would seem to be a curious target. For a start, substitutes are available. For instance, the European Union recently approved the use of vegetable oil in place of cocoa butter, which is more expensive. Past attempts at cornering commodities have ended in tears. In the metals market, the stab by the Hunt brothers of Texas to corner the silver market ended in huge losses two decades ago. Yet some say that London's cocoa market—where speculators can punt on far more futures contracts than they can in New York—might be an easier place to stage a bid for control. As evidence, they point to the wide difference in futures prices between the two cities.

Chocoholics need not hugely fear steeper prices, for chocolate is driven more by the price of milk and sugar than by the price of cocoa. Besides, big chocolate companies are more likely to produce smaller bars than raise prices, even if cocoa soars further. They're just doing you a healthy favour.

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Auditing

It could happen here

Jul 11th 2002
From The Economist print edition

Accountants face reform in Britain as well as America

BRITISH accountants have always considered themselves superior to their fellows in America. The Brits tend to come with better grades and from better universities. Many even took degrees in subjects other than pure accounting. This means, naturally, that they are possessed of more strength of character and backbone when facing finance directors intent on cooking the books.

American auditors now face strict new laws on audit independence. But British accountants reckon that their greater abilities mean that there is no need for radical reform. In any case, they say, Britain has responded to its own audit nasties—such as BCCI, Polly Peck and Maxwell—in the late 1980s and early 1990s, with new accounting standards and tougher regulation.

The government is not so complacent. Patricia Hewitt, Britain's trade secretary, has said that the group that she and the Treasury set up to examine the state of British accounting should consider bringing in compulsory rotation of audit firms or audit partners. Another way to tackle cosiness between auditors and clients, according to Ms Hewitt, would be an enhanced role for audit committees, such as the ability to hire and fire auditors, currently the responsibility of executives. The provision of non-audit services to audit clients, she said, should also come under scrutiny.

For the moment, accountants in Britain are hoping that Ms Hewitt was simply saying the things she had to say following the WorldCom scandal in America. Yet there is no doubt, says the chairman of Ernst & Young in Britain, Nick Land, that this latest audit scandal has added fuel for reform in Britain as well as America.

Accountants in both countries have been fighting hard against meaningful change. In Britain, Lord Borrie, chairman of the Accountancy Foundation, the independent body responsible for the regulation of accountants, felt it necessary to rebuke the profession's leaders for their rejection of reform. The industry's trade body in America has been especially strident in its denunciation of legislation proposed by Senator Paul Sarbanes, arguing that it would create an unnecessary bureaucracy and do harm to investors.

British auditors will similarly resist many fixes that non-accountants propose for improving the quality and independence of audits. Compulsory rotation of audit firms, for instance, is said by audit firms not to have worked in Italy, where fees for audits often went down when the audit came up for tender—meaning, in the end, less time spent checking the numbers. Auditors were suspected of doing worse audits in the final years, knowing that they would lose the client. But since the profession, on both sides of the Atlantic, has come up with little to stop its members cuddling up to clients, it may have to start listening with a more open mind to ideas from outside.

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Crédit Lyonnais

Questions, questions

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More conclusive evidence in the Executive Life affair

Reuters

Peyrelevade peruses

CREDIT LYONNAIS has maintained that wrongdoings over the purchase in 1991-93 of Executive Life, an American insurance company, did not come to the attention of Jean Peyrelevade, the French bank's chairman since November 1993, until late 1998. In America the bank faces criminal proceedings and is a defendant in a civil lawsuit over Executive Life.

Mr Peyrelevade is suing *The Economist* for alleged libel in articles, published last year, which concluded that he either knew, or should have known, the full details of the Executive Life affair before 1998. *The Economist* has rejected the accusations of libel and is confident that it can justify its stories. We have recently obtained further documentary evidence that reinforces the conclusion of our earlier articles. These documents raise new difficulties for Crédit Lyonnais as it defends itself in the investigations in America.

After Executive Life went bust in 1991, insurance regulators chose a rescue package put together by Crédit Lyonnais. As part of the deal, the bank arranged for a new insurance company, Aurora, to take over Executive Life's insurance contracts. Regulators were told that a consortium set up to own and manage Aurora would be independent of Crédit Lyonnais, as both federal and state laws required.

However, members of the consortium of “independent” shareholders in Aurora, led by MAAF, a French insurer, were in fact acting illegally as fronts for Crédit Lyonnais. The bank had confidential agreements to buy back shares in Aurora from consortium members. The bank also arranged in principle for Artémis, controlled by François Pinault, one of France 's richest businessmen, to buy shares in Aurora from the consortium of investors, so that the fronting scheme could be unwound.

A trail of documents suggests that this deal was widely discussed within the senior management of Crédit Lyonnais. As we have reported, a 17-page internal fax was sent to Mr Peyrelevade's office on December 10th 1993. It discussed in detail the bank's relationship with Artémis and openly referred to the American regulatory reasons why shares in Aurora could not overtly belong to the bank—hence the fronting scheme. Mr Peyrelevade claims he did not read the fax and was not aware of its contents until 1999.

However, on December 13th 1993 the bank's four-man executive committee, chaired by Mr Peyrelevade, convened for a routine meeting. It discussed, among other business, Artémis and the Executive Life deal. A “points for action” document drawn up after the meeting referred to the buyback of American assets (that is, shares in Aurora) and described a need to “avoid 100% financing (Fed consideration)”, clear evidence that the bank's most senior figures were fully aware of the regulatory implications of the deal.

The obvious conclusion is that the 17-page fax sent three days earlier was intended as preparatory material for the meeting. And Mr Peyrelevade's personal involvement in the Executive Life dossier deepened in 1994. His intervention was required because Artémis wanted Crédit Lyonnais to finance its purchase of shares from the consortium. For regulatory appearances the bank could not do this directly, so instead it proposed to refinance a recent acquisition by Artémis from the undrawn part of an existing credit line. As Artémis, heavily indebted, was on the bank's watch-list, the bank's operations committee, made up of Mr Peyrelevade and senior managers, had to give its approval.

The minutes of the committee's meeting on March 18th 1994 record that: “The chairman [Mr

Peyrelevade] emphasised however that the credit line intended to finance the *portage* of the Aurora shares had not been used, which meant that the bank's outstandings would, in fact, increase if the new loan were granted."

This statement does not directly prove that Mr Peyrelevade knew about the banks' wrongdoings, since these mainly involved filings designed to conceal the existence of the fronting arrangements from American regulators. But the purpose of the fronting arrangements was to keep the true ownership of Aurora hidden from regulators while Mr Pinault gradually acquired the shares. On this point Mr Peyrelevade's stated position falls down.

Did Mr Peyrelevade ask the obvious question: why did the fronting arrangements exist? The bank's head of communications, Nicolas Chaine, declines to answer our written questions. Instead, he asserts that *The Economist* is prone to misinterpretation of the documents, is wilfully misleading its readers, and is violating French bank-secrecy law.

Yet consider the implications of the possible answers. If Mr Peyrelevade did not ask, either he already knew and therefore had no need to; or he overlooked a basic question relating to the bank's regulatory risk, in which case he should have asked. If he did ask, there is no reason to suppose he would not have been told the reasons, since they had already been given in the 17-page fax. The conclusion that Mr Peyrelevade knew or should have known the full details of his bank's involvement in Executive Life is inescapable.

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Economics focus

Taken for a ride

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The pay of chief executives can seem ridiculous. Often, it is

IN CORPORATE America's crisis of confidence, bosses' pay looms large. Public opinion probably sees this as the worst of the scandals in question. Many economists, inclined to give markets a chance, take a different view. They reckon the market for scarce talent is working pretty well. They are most likely wrong.

In thinking about executive pay, economists reach first for optimal contracting theory. According to this view, corporate boards design executive pay to mitigate the "principal-agent problem" that bedevils the relationship between shareholders and managers. Boards aim to align the interests of managers with the interests of owners by building various incentives into managers' contracts.

Seen this way, the technology for aligning incentives has been improving lately—witness the growing, and in some cases dominant, role of stock options in top executives' pay. These schemes sometimes hand out vast sums. According to the optimal contracting model, this is good for owners, because it rewards managers for doing things that increase the value of the company. Once in a while, advocates concede, such plans may be abused. Crooked bosses may manipulate stock-option plans to subvert the principle; no scheme is proof against outright dishonesty. By and large, though, the growth of stock-option plans is not to be deplored, but should be welcomed as a step forward in corporate governance.

Does the optimal-contracting view make sense? A recent paper* by three scholars from Harvard Law School and the University of California, Berkeley, says it does not. They advocate another approach, which they call the managerial-power view. They plausibly argue that it makes better sense theoretically and empirically. And they draw from this approach the interesting implication that many (not a few) top executives are skimming mighty rents—incomes in excess of what market efficiency and maximum shareholder value would dictate—from the people who employ them.

The key assumption of the optimal-contracting view is that managers and shareholders, in effect, negotiate at arm's length over pay. Basic training in economics is needed to blind one to the absurdity of this assumption. Top managers direct or at the very least influence the board members who set their pay: that means they will succeed in collecting some rent. The only question is how much.

One of the constraints on this activity will be how angry shareholders and the public at large get about bosses' pay: the paper talks of norms of acceptable behaviour and "the outrage constraint". The importance of public relations puts a premium on compensation schemes that disguise managers' terms. In theory, stock options could align managers' incentives with shareholders' interests. In practice, very often, they are used mainly to conceal the diligent collection of rent—quite possibly with perverse, not merely neutral, implications for incentives.

Consider the following features of stock-option plans as typically implemented by big American companies:

•**Rewarding mediocrity**. Optimal contracting would lead you to expect a stock-option design that filtered out general rises in stock prices, so that bonuses were paid only for better-than-average performance against some relevant benchmark. Such features, the paper shows, are rare.

•**At-the-money options**. Optimal contracting would suggest great variety, according to circumstances, in the exercise price of the options granted. (By varying the exercise price, the power of the incentive can be fine-tuned.) There is no such variety. Options are almost universally granted with an exercise

price equal to the prevailing market price.

•**Resetting**. The incentive effects of options are undone if executives expect prices to be reset when the company's shares fall. This is a widespread practice.

•**Unwinding**. A requirement of optimal stock options is that managers should be unable to hedge the risks the options create. Hedging is almost never prohibited. Also, almost invariably, managers are allowed to cash out their options as soon as they are vested. (Incentives aside, managers have inside information: this allows profits to be made at the expense of public shareholders.) Logically, boards should restrict and control the sale of bosses' shares. They rarely do.

•**Reloading**. This is the practice of letting executives exercise options when the share price is high, at the same time granting new options with the old expiration date. This lets managers profit from volatility in share prices even if the overall trend in the company's value is flat. It should be rare. It is common.

This is to say nothing of “gratuitous payments” (bonuses, often related to acquisitions, for which the firm was under no contractual requirement, and which served no incentive-related purpose). None of these aspects of executive pay in practice, the authors contend, can be easily explained by optimal contracting. They can be easily explained by managerial power—that is, by rent extraction.

How to remedy this is not an easy question. Aggressive regulation could do more harm than good. But note that outrage, as in the outrage constraint, has its uses. Economists who defend bosses' outlandish pay may be serving the cause of market forces badly. Tighten that constraint. More deploring and less defending would help curb those rents.

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* “Managerial Power and Rent Extraction in the Design of Executive Compensation” by Lucian Bebchuk, Jesse Fried and David Walker. Forthcoming in the University of Chicago Law Review.

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Human evolution

In the beginning

Jul 11th 2002

Ancient skull, new theories

WIND the clock back 10m years and the earth was, quite literally, a planet of the apes. Then wind the clock forwards 5m years. An important change has occurred: hominids, the ancestors of modern humans, have by then diverged from those of chimpanzees, which are mankind's closest living relatives. What happened in between, during that crucial period of human evolution, has remained a mystery. The surviving fossils from this period would just about fill a small shoe-box and, scoffs one palaeontologist, typically resemble "crushed cornflakes".

The discovery of a near-intact hominid skull from this period has therefore created quite a splash. That discovery, by Michel Brunet of the University of Poitiers, France, and his colleagues, was reported in this week's *Nature*. *Sahelanthropus tchadensis*, as the fossil has been dubbed because it was unearthed in the Djurab desert in Chad, is more than 3m years older than the next oldest known hominid skull.

Apart from its sheer age, what interests palaeontologists about Toumaï, as the skull has been nicknamed, is the unusual mixture of apelike and hominid features that it displays. Dr Brunet says that the small size of the skull suggests Toumaï was probably close to the size of a chimpanzee. However, while the case of its brain resembles that of a chimp, its face is short, which is a rather more human feature. The teeth of the fossil, in particular its canines, are small and more like the teeth of a human. It also has pronounced brow ridges, which before now had been found only in hominids dating from 2m-5m years ago. Because no limbs were preserved, it is impossible to tell whether Toumaï was a biped or a quadruped.

A lone skull, unfortunately, reveals very little—except that the Djurab desert looks like a good place to dig for more. That has not stopped palaeontologists speculating, of course. Some see in the mixture of features a direct ancestor of modern humanity. That is unlikely – for statistical reasons, if no other. More probably, *S. tchadensis* was one of several primitive hominids alive at the time. Evolution rarely works in a linear fashion, with species A evolving neatly into species B. Either species A goes extinct, or it evolves into B, C, D and so on.

A similar process happened with *Homo sapiens's* immediate ancestor, *Homo erectus*. That broke up into several species, which co-existed for a while. But with the rise of sapiens, the others became extinct. Finding out whether Toumaï was on the main line to humanity will require a lot more fossils to be dug out of the Chadian desert.

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AIDS

Hope for the best. Prepare for the worst

Jul 11th 2002 | BARCELONA
From The Economist print edition

AP

AIDS activists and researchers gathered in Spain to exchange ideas last week. Not all was doom and gloom

Get article background

THE International AIDS Conference, held every two years, is not like any other scientific meeting. It is hard to imagine being greeted at the door by stilt-wearing actors dressed as Buddhist monks and giraffes at a conference on particle physics, or even malaria. This disease, however, is not like any other. Humanity has come to terms with most of the ills that flesh is heir to. People may not like them, and medical science works against them, but they are known quantities. AIDS is still an unknown quantity. The numbers bear emphasising, lest familiarity breed contempt. In the 20 years since the disease was recognised, more than 20m people have died from it. Another 40m are infected. New infections are occurring at the rate of 15,000 a day, and the rate is still increasing. Unless there is a significant change for the better, almost all of these people will die from the disease, too.

On top of that, AIDS is spreading. By far the worst affected continent is Africa. That is where HIV, the virus that causes the disease, leapt the species barrier from chimpanzees to people some 70 years ago. But infection rates are rising, in several cases rapidly, in many Asian countries and in many of the successor states to the Soviet Union. At the moment, the place with the largest number of cases is South Africa. Before long, India and China may overtake it. If and when they do so, though, they could merely be at the beginning of their epidemics—their populations being so much bigger than South Africa's that even South-African-style numbers translate into relatively low infection rates. And South Africa itself was blessed, if that is the word, with rates as low as those in India and China as recently as a dozen years ago.

Conferences on AIDS, then, are as much councils of war as scientific meetings. They offer an opportunity to take stock, review progress and plan the next phase of the campaign. They are also places where the “AIDS community”—of sufferers, activists, scientists, health workers and policymakers—reviews its mood. Surprisingly, the mood in Barcelona, where the 14th of these conferences has just been held, was cautiously optimistic.

Whistling in the graveyard

At the previous conference, in Durban two years ago, it was agreed that there was enough knowledge of what needed to be done to stop the rot. It was, therefore, only a question of doing it. First, spread the use of condoms. Second, curb mother-to-child transmission with cheap, one-shot drugs given just before

birth. Third, empower women to choose freely whether and with whom they have sex, and what sort of contraception they use. Fourth, perhaps above all, educate people about the risks they face. Encouragingly, several countries had shown that all this could be done. The favourite examples trotted out were Uganda, Senegal and Thailand.

There was also a feeling in Durban that the rich world, which had stopped paying attention to AIDS when drugs that could control (though not cure) the disease came on stream, was taking notice again. The hope that such notice might be translated into money was reinforced when Peter Piot, the head of UNAIDS, the United Nations agency charged with curbing the disease, invented the idea of a “Global Fund for AIDS”.

This idea was picked up a year ago by Kofi Annan, secretary-general of the United Nations, and turned into reality. It has, in the process, been diluted, so that it is now a fund for tuberculosis and malaria as well. But although that risks introducing a lack of focus, the three diseases, all big killers, do tend to co-occur. Moreover it is the weakening of people's immune systems induced by AIDS that has allowed tuberculosis to rear its head again, after decades of decline.

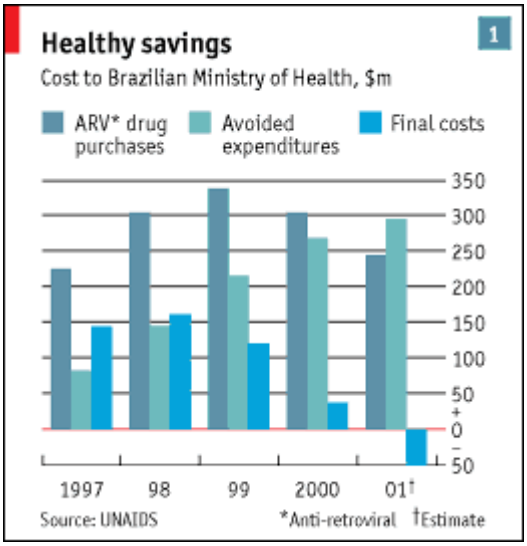
Another change for the better since the Durban conference has been a shift towards treatment for all. Until a couple of years ago, prevention was seen as the priority in poor countries. That made sense for two reasons. First, and positively, prevention is better than cure—particularly when an epidemic is growing exponentially and each blocked transmission prevents multiple infections further down the line. Second, and negatively, the cure was too expensive to be worth considering; a year's course of highly active anti-retroviral therapy (HAART) cost $10,000-15,000. A third reason, less discussed in public, but real enough, was a fear that requiring complicated treatment regimes of uneducated people would result in non-compliance and the emergence of drug-resistant strains of the virus.

Much of that has changed in the past two years. First, there is a wider recognition that people who are infected and cannot be treated have little incentive to get tested; that, in turn, means they do not know they are infected, and so do not take precautions against infecting others. Second, the drugs have got a lot cheaper: sometimes as cheap as a dollar a day. Third, experience has shown that people will comply with drug regimes if they are explained properly. The Barcelona conference, if it did nothing else, therefore marked the point of reconciliation between those who emphasised stopping new infections and those who emphasised caring for those already infected.

Give us your money

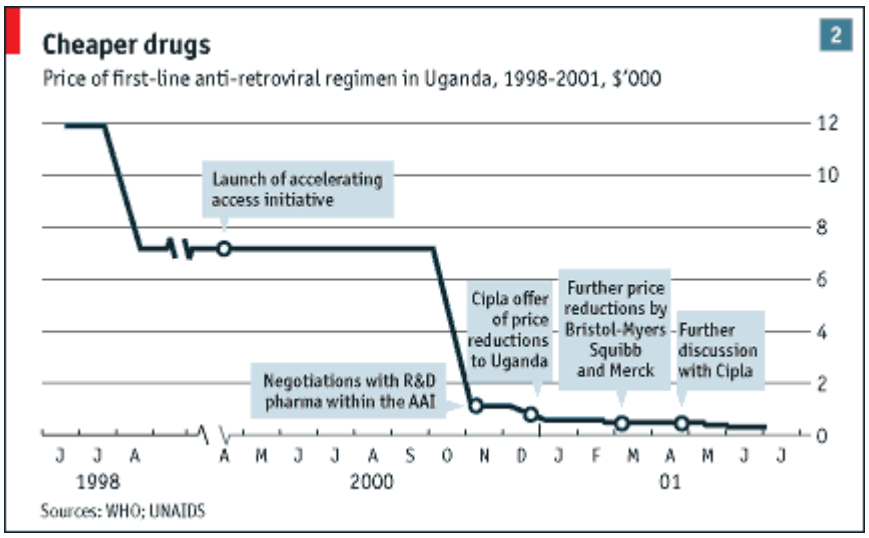
The emergence of the Global Fund is part of the reason for that convergence. Its creators wisely emphasised both prevention and treatment in its remit, thus reducing the scope for argument about who gets how many dollars. People also have the example of Brazil in front of them, to point out what a well-organised treatment campaign can achieve in a country that, if not exactly at the bottom of the economic heap, is certainly nowhere near the top.

In 1992, as Marco Vitoria, of the Brazilian health ministry, told the conference, a World Bank model predicted that 1.2m people in Brazil would be infected with HIV by this year. The actual figure is 600,000. In part, that is because 150,000 people are on HAART. Since HAART reduces a person's viral load to a negligible level, it helps to curb transmission to others, besides maintaining the health of the patient. This treatment was made free at point of use by the Brazilian government in 1996 and, as a direct result, the number of people dying of AIDS in Brazil has fallen by 50%. The decision has also been good economically. As chart 1 shows, savings made by the government on treatment that would otherwise have been necessary now outweigh the cost of the drugs.



Those savings have been possible, though, only because anti-AIDS drugs in Brazil are cheap. Some are manufactured there as patent-busting generics (permitted under the Agreement on Trade-Related Aspects of Intellectual Property Rights, TRIPS, to deal with national emergencies). The existence of those generics has strengthened the government's position in negotiations with drug companies to buy their non-generic versions.

The price of HAART has come down dramatically (see chart 2). That is thanks to TRIPS, to the "accelerating access" programme agreed between UNAIDS and several of the drug companies to introduce "tiered pricing" for poorer parts of the world, and to bilateral donations by the drug firms themselves. Nevertheless, even at a dollar a day, it is beyond the purse of most Africans. Only 30,000 people in that continent use it. Only diamond-rich (and democratic) Botswana has an official anti-AIDS drug programme in place. Other countries await fairy godmothers who will help them pick up the bill.



The question of who pays is, of course, at the front of everybody's mind. When the Global Fund was announced, Dr Piot and Mr Annan said it would require $7 billion-$10 billion a year, once it was up and running. In practice, it has attracted only $2.1 billion in its first year of existence.

However, $2.1 billion (largely from governments, though some has been chipped in by the Gates foundation) is not a bad start. Potential donors will be watching to see how it is spent. If wisely, it is likely more will follow.

How much money is actually needed depends on what assumptions you make. A mathematical model developed a year ago by Bernhard Schwärtlander of the World Health Organisation and his colleagues estimated the maximum amount that could be spent usefully per year by 2005 as about $9 billion. That assumed there were no significant changes in the medical infrastructures of poor countries. Of that, $4.8 billion would be allocated to prevention, and $4.2 billion to treatment. At the moment, according to the Global HIV Prevention Working Group, a cabal of experts financed by the Gates and Kaiser foundations, about $1.2 billion is spent on prevention in the world's poor countries. In a paper published in the *Lancet* to coincide with the conference, John Stover, of Futures Group International, and his colleagues estimate that increasing spending on prevention to the $4.8 billion that Dr Schwärtlander recommended could avoid 29m infections by 2010—if the money were spent well.

Strengthening the medical infrastructure of these countries would obviously cost more. The Commission for Macroeconomics and Health (CMH), headed by Jeffrey Sachs, a well-known development economist based (from this month) at Columbia University, reckons that infrastructure investment would raise the price to about $15 billion. Whatever the exact cost, Mr Sachs announced at the conference that CMH, UNAIDS and the Global Fund were pooling their resources to develop a plan to deal with the global epidemic, details of which would be hammered out within three months.

At the moment, therefore, the thrust of efforts to curb the epidemic and treat those affected is through public policy. But scientists are also making advances.

The medicine chest

One reason that HIV is such a difficult adversary is its mutability. Every time the virus replicates there is, on average, one mutation in its genetic material. An infected individual can contain as many as 100 billion virus particles. The result is that all possible "single point" mutations (that is, alterations of a single "letter" in the virus's genetic code) exist simultaneously in heavily infected people. Some of those mutations will undoubtedly protect the virus against a particular drug, so long-term dosing with that drug selects for the protective mutations and leads to the evolution of resistance.

Preventing the emergence of such resistance is the logic behind HAART, which works by using a combination of molecules that attack different parts of the viral life cycle, in the knowledge that simultaneous mutations that overcome all lines of attack will be rare. HAART mixes drugs that interfere with the action of two of the three enzymes that HIV relies on to persuade cells to replicate it. These enzymes are protease, which prepares viral proteins for action, and reverse transcriptase, which converts the virus's genes into a form that can be read by the host cell.

There are now 140 different approved variations of HAART. Resistance has, nevertheless, emerged. In America, where HAART has been employed since 1996, almost 80% of those who have been using it for more than two years have resistant strains of virus in their bloodstream. Worse, 20% of those infected but not treated have resistant strains, since these are now being passed from person to person. One way to combat this growth of resistance is to add more drugs, with novel mechanisms. Several ways of doing this were discussed at the conference. None would be used as a therapy by itself, but each should reduce the rate at which resistant strains of the virus emerge.

The most advanced is a drug known to its inventor, Trimeris Pharmaceuticals of Durham, North Carolina, as T-20. It belongs to a class of molecule known as fusion inhibitors. These stop the virus docking with its target cells. If a virus cannot dock, it cannot infect. Docking happens in a two-stage process. First, a viral protein called gp120 links up with two other proteins on the surface of the target cell to form a so-called docking complex. Second, the docking complex is discarded and another viral protein, gp41, links the viral membrane with that of the cell, allowing the virus's contents to enter.

Trimeris's compound interferes with gp41, stopping the second part of the process. Trimeris, in collaboration with Roche, a pharmaceutical company with rather larger resources, has brought T-20 to phase-III trials—the last stage before approval by the regulatory authorities. The results of these trials, announced at the conference, suggest the drug works—at least in patients who otherwise face death because their infections have become resistant to the existing classes of drug. T-20 has its problems: in particular, users have to inject it twice a day. But the trials found that most participants were willing to put up with this in exchange for an extension of their lives. And, apart from bad reactions at the injection site, T-20 seems to have no side effects.

Another possible approach is to interfere with the activity of the third viral enzyme, integrase. This enzyme is responsible for stitching HIV's genes into the host cell's chromosomes. Once there, these genes are read by a cell as though they were its own, and converted into new viral proteins. These then assemble themselves into new viruses.

Until now, integrase inhibitors have been little more than a gleam in researchers' eyes. They have produced tantalising results in cell preparations, and in monkeys infected with simian viruses similar to HIV. Now, one has been put into people by Merck, a pharmaceutical company. At the conference, Merck announced that preliminary trials suggest that the procedure is safe. Bigger trials may therefore follow.

The third new approach concentrates on the cell-surface docking proteins. One of these is called CD4. This molecule is found in certain cells of the immune system, which is why that is the part of the body affected by HIV. Blocking the link between gp120 and CD4 has not been a fruitful line of research. It has, however, proved possible to gum up the second cell protein involved in the docking complex. HIV can actually use one of two proteins as this so-called co-receptor. Most versions of the virus employ a molecule called CRC5 as the co-receptor. A few use a related molecule, CXCR4. Several companies have drugs molecules that are a perfect fit for CRC5. By binding to it, they deny it to gp120, and thus—it is hoped—block the infection. Some of these molecules, including ones developed by Schering-Plough and Progenics, and discussed at the conference, are now in early human trials.

For complete protection, gumming up CXCR4 would be necessary, too, and AnorMED, a Canadian firm, has carried out preliminary trials which show that this might be possible. None of these approaches, except T-20, is close to market. But all offer hope that the problem of resistance to existing drugs can be overcome.

A jab at a solution

On vaccines, the other important scientific front, the news was gloomier. There was much brave talk of the number of new ideas for vaccines that are undergoing, or about to undergo, preliminary trials. But the truth is that there have always been a fair number of these preliminary trials. Only one vaccine, however, is in serious, phase-III trials. This is VaxGen's gp120 vaccine, and a lot is riding on it.

This vaccine, as its name suggests, works by presenting the immune system with large quantities of gp120 (the protein is manufactured “transgenically” by stitching the appropriate gene into a bacterium, and multiplying the bug in a reactor). The idea is to show the immune system what this molecule looks like, so that it can react rapidly to produce appropriate antibodies should it be faced with gp120 on the surface of hostile virus particles. VaxGen, a company based in Brisbane, California, actually has two trials going on. As Donald Francis, VaxGen's boss, confirmed to the conference, the more advanced of these will report early next year. This is based in North America and the Netherlands, and uses gp120 from two forms of the B strain of HIV, the strain of this very variable virus that is most common in the rich world. A second trial, which will report about six months later, is taking place in Thailand. This uses the B and E strains, more closely matching the mixture of viruses in South-East Asia.

Dr Francis was bullish. Many people are sceptical about the idea of an antibody-stimulating vaccine. They point out that the antibodies induced naturally by HIV don't seem to do much good, and prefer the idea of stimulating another part of the immune system, cells known as cytotoxic lymphocytes which kill infected cells. However, VaxGen's vaccine works in monkeys and, as Dr Francis points out, all successful vaccines so far have relied on antibodies. Nevertheless, next year a third phase-III trial will start, again in Thailand. It will test a combination of the gp120 vaccine and one that stimulates cytotoxic lymphocytes.

If the VaxGen trials turn out negative, gloom will descend with a vengeance. Even if they turn out positive, there will be problems to resolve. First, the process will have to be repeated for the other principal strains of HIV, particularly those circulating in Africa. Second, the infrastructure to deliver the new vaccines will have to be put in place. Considering that many existing vaccines are not deployed properly in poor countries that need them, for lack of a suitable infrastructure, that will be a tall order. Of course, AIDS is to a certain extent a magic word. If you invoke it, things can sometimes happen that do not if you say “hepatitis” or “measles”. But the latest obsession of Seth Berkeley, the hyperactive head of the International AIDS Vaccine Initiative, is to try to get a vaccine-delivery infrastructure in place in these countries before there is even a vaccine.

This politically ambitious scheme, Dr Berkeley thinks, might be sold on the back of a system for delivering vaccine for hepatitis B. The hepatitis B virus is transmitted in a similar fashion to HIV, that is, predominantly sexually, with contaminated blood transfusions as a secondary cause. It is also quite widespread. There is, however, already an effective vaccine, although this vaccine needs to be disseminated more widely. What better way to have a trial run for delivering an AIDS vaccine, if and when one turns up, than to build a truly efficacious network for distributing hepatitis B vaccine?

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Political essays

Conversations with the dead

Jul 11th 2002
From The Economist print edition

Two of Britain's best prose writers—a novelist and a journalist—confront the errors and evasions of an earlier generation in politics

IS IT coincidence? These two new books, written by old London friends and dedicated to the same literary godfather, deal respectively with Josef Stalin's crimes and George Orwell's virtues—related topics of moment if not quite the moment. As the need for more words on either subject is far from obvious (Stalin's virtues, Orwell's crimes?), a lot here is going to hang on the angle and on the writing.

In a large body of justly celebrated fiction, Martin Amis has seldom been content simply with satiric bite or verbal brilliance: he has usually aimed also to confront broad and challenging themes such as commercialism, nuclear war and the Holocaust. An essay from him on Stalin and his dupes feels like a natural continuation. Christopher Hitchens, a clever and contrarian British journalist living in Washington, DC, has frequently expressed in articles his admiration for the anti-Stalinist Orwell. Now in a book he makes a spirited defence of his author-hero against all who, in his eyes, have traduced or misinterpreted him.

It helps that Messrs Amis and Hitchens are practised in the use of side, or English as they say in pool. Each can bend a sentence till you break out laughing. Both put their own concerns and passions prominently into play. Mr Amis, in particular, dwells movingly on his family, and finishes with an open letter to Mr Hitchens.

Their joint dedicatee is Robert Conquest, a British poet and author of a widely cited study of Stalinist oppression, “The Great Terror” (1968), which put forward the canonical figure of 20m victims. Mr Conquest was a friend of Kingsley Amis, Martin's late novelist-father, and he wrote a fine poem in homage to Orwell, with which Mr Hitchens opens. Clearly, “Koba the Dread” and “Orwell's Victory” are not run-of-the-mill rehashes, but offer something distinctively personal, involving filial piety, contested ideals and conversations with the dead.

The middle and longest part of Mr Amis's book is a catalogue of Stalinist horror—Koba was a nickname—replayed from wide study of familiar sources. It is worth reading even if you think you know this appalling record already, if only for the vehemence and urgency of Mr Amis's prose. The horror matters, he is saying,

Koba the Dread: Laughter and the Twenty Million
By Martin Amis

Talk Miramax; 306 pages; $24.95.

Buy it at
Amazon.com
Amazon.co.uk

Orwell's Victory
By Christopher Hitchens

To be published in the United States as "Why Orwell Matters" by Basic Books in September. Allen Lane; 150 pages; £9.99.

and it matters that there were westerners who thought it didn't (his father, for one, was a communist until 1956).

Buy it at
Amazon.com
Amazon.co.uk

Stalinism, all the same, has to be understood (*comprendre* isn't *tout pardonner*). Was it the corruption or culmination of socialist ideals? Who was to blame: Stalin, the Bolsheviks or Russians who got ahead in the system? Were totalitarianism and industrial genocide developmental diseases of the 20th century or manifestations of a deeper human propensity for evil? Rather like a restaurant diner who waves at the entire menu and says, “Yes, I'll have that”, Mr Amis seems to want to blame Utopian ideals, Stalin and evil simultaneously.

Despite the mockery and jokes, the prevailing mood is melancholy. As in his autobiographical “Experience” (2000), Mr Amis muses on the deaths of a loved and admired father, a younger sister, and a young brother-in-law. Indeed, “Koba the Dread” may best be taken as a work of mourning, though with a characteristic Amis twist in that he seems to want to personalise mass suffering by publicising private grief. What is one family's loss against 20 million? What are a distant 20 million to one family in pain? Not every writer has the confidence—or the wit—to take on such heavy themes.

Moral and mental glaciers

Orwell would probably have understood what Mr Amis is up to, though wanting it put more straightforwardly. Sincerity and individual engagement mattered to Orwell more than doctrine or policy. Politics for him started and ended with personal responsibility. His own views grew out of experience, not theory: hatred of colonialism from police work in Burma, loathing of communists from watching them as an infantryman fighting fascists in the Spanish civil war, a lifelong belief in socialism out of repugnance at inequality—“A fat man eating quails while children are begging for bread is a disgusting sight”—which he combined, to the bafflement of the unwary, with contempt for most socialists.

Orwell in short was a slippery customer, and Mr Hitchens wants to rescue his unbiddable hero from all attempts to imprison him in some camp or other, be it the anti-socialist right or the anti-American left. Why, to adapt an old radio joke, is Orwell like a chophouse? Because everyone wants their own stake in him.

Mr Hitchens takes us through Orwell's anti-colonialism (“unswerving”), his Englishness (deep), his view of America (in its contest with Russia strongly for, but culturally hostile); and his attitude to women (confused). He rejects the charge that Orwell was a McCarthyite sneak in giving a Foreign Office friend a list of pro-communist writers who ought not be asked to do cold-war propaganda for Britain. He appraises the novels: in his view, only the anti-communist fable, “Animal Farm” (1945) and “Nineteen Eighty-Four”, his dystopian vision of global tyranny (1949), rise to the level of the finest essays or “Homage to Catalonia”. He defends him against the post-modern delusion that honesty and clarity—Orwell's virtues as a writer—are in the eye or pocket of the beholder.

For readers new to Orwell and the grievous rows he caused even before his early death from TB in 1950 at 46, “Orwell's Victory” is a good, forcefully argued introduction. (It nods generously to Bernard Crick's model 1980 biography and to Peter Davison's indispensable complete Orwell edition.) Existing devotees should thank Mr Hitchens for stripping off layers of ideological over-paint, even if, as with every restoration, he adds a few of his own.

And where does Mr Hitchens stand? A Trotskyist in youth who now backs America's war against terror, he is hard to place. Mr Amis in his letter chides his friend for not having fully renounced left-wing ideals. But uncertainty about Mr Hitchens's politics is probably no greater than it is with his politico-literary father-figure.

Orwell once praised Charles Dickens for the vagueness of his radicalism. He could have been talking about himself. He did not mean evasiveness or lack of clarity, but an emotional perception that something was wrong with society and that the only constructive suggestion was “Behave decently”. That sense of decency, Mr Hitchens seems to be telling us, is what in the end we should most admire in the politics of this singular man. And such distrust of doctrine is not so very far from the quietist position Mr Amis recommends in a heartfelt letter to his father after his death: “You were ideological and I am not.”

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By Martin Amis.
Talk Miramax; 306 pages; $24.95.

To be published in Britain by Jonathan Cape in September

Orwell's Victory.
By Christopher Hitchens.
Allen Lane; 150 pages; £9.99. To be published in the United States as “Why Orwell Matters” by Basic Books in September
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About sponsorship

States and wars

Marketing the nation

Jul 11th 2002
From The Economist print edition

“WAR, peace, and the course of history”. The subtitle alone shows that this is an ambitious work. It starts with a long chunk of Homer and ends with a quotation from Paul Valéry. In between are poems, theses, futurological disquisitions and references to everyone you have ever heard of, and to some you may not have. It is a sprawling, Texas-sized work, appropriately both because its author, Philip Bobbitt, is a professor of constitutional law at the University of Texas and because it has caught the attention of the Texan-led administration that now holds sway in Washington, DC.

The Shield of Achilles: War, Peace, and the Course of History
By Philip Bobbitt

Knopf; 976 pages; $40.
Allen Lane; £25

Buy it at
Amazon.com
Amazon.co.uk

The book's central idea is that of the “market-state”. This is a state whose purpose is to maximise the opportunities for all members of society. Unlike the nation-state, it seeks to be no more than a minimal provider or redistributor. Its economic arena is the marketplace, not the factory. It is, Mr Bobbitt says, indifferent both to culture and to the norms of justice. It is, however, interested in preventing social instability. Dependent on the international capital markets, it is less representative but more democratic than the nation-state. It achieves its objectives by incentive structures and sometimes draconian penalties.

Mr Bobbitt argues that the society of nation-states is decaying, to be replaced by one of market-states. This new society will be faced by all sorts of challenges arising from the strategic innovations that won what he calls the Long War, the twice-interrupted struggle that began with the first world war and ended amid the rubble of the Berlin Wall. Different forms of market-state—entrepreneurial, mercantile or managerial—will evolve, depending on the degree of sovereignty retained by the people. The ways in which these different forms cope with the new challenges is what will structure the conflicts of the new society.

Conflicts, however, are inevitable. Indeed, the world is about to undergo another “epochal war”, perhaps a low-intensity affair, or perhaps something much nastier, even a cataclysm of global proportions involving weapons of mass destruction. In this new age, argues Mr Bobbitt, only a market-state will be able to carry out the necessary shift from retaliatory, threat-based strategies to defensive, vulnerability-based ones. Even so, dark days lie ahead, for, after five centuries in which only a state could destroy another state, “We are entering a period...when very small numbers of persons, operating with the enormous power of modern computers, biogenetics, air transport, and even small nuclear weapons, can deal lethal blows to any society.” Accordingly, it is necessary to create a new world from the inherited political institutions of the old, something that requires an understanding that has been called upon perhaps no more than half a dozen times in the past 500 years. Mr Bobbitt's aim is to enhance this understanding.

Alas, he fails. It is not necessary to believe that a few people can yet destroy a state, or at least a state much bigger than Luxembourg or Singapore, to share Mr Bobbitt's alarm about the condition of the world. Similarly, it is not necessary to concur in his vision of a society of market-states to agree that the world stands at the threshold of a new age, marked partly by the end of the old wars of the 20th century and partly by technological change, including the development of new weapons. This is certain to have profound effects on the nature of the state, just as it will place new demands on the state's capacity to make a successful strategic response.

Such thoughts, though, are hardly new. Unfortunately, the most interesting new idea in Mr Bobbitt's book—the concept of the market-state—does not seem to be a recognisable entity, least of all in the places where he sees it evolving, notably the United States. It is simply unimaginable to see how

America, the first country to be founded on ideas, the rule of law prominent among them, could ever become indifferent to the norms of justice. In the aviary of states, nations and constitutions, the market-state simply does not fly.

In the confusion of Mr Bobbitt's learning, it is true, some fair points are made. It would be extraordinary if it were otherwise in a book of some 900 pages. But what at the outset promises to be magisterial and erudite in the end turns out to be merely long-winded and pretentious.

The Shield of Achilles: War, Peace, and the Course of History.
By Philip Bobbitt.
Knopf; 976 pages; $40.
Allen Lane; £25

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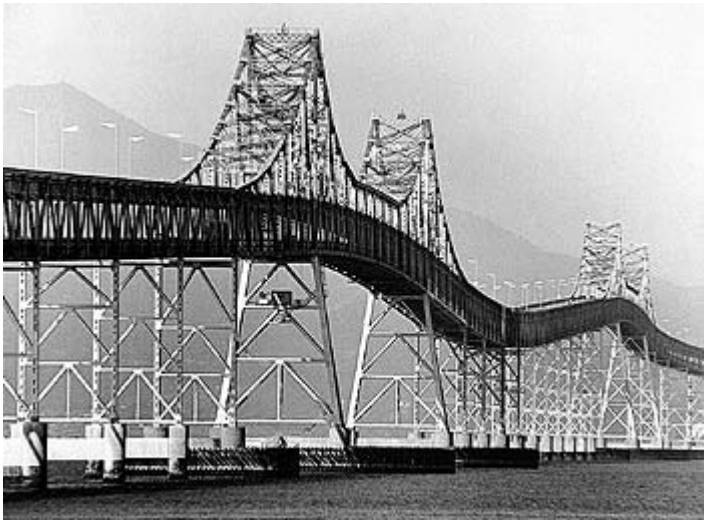
Graceful arches

American bridges

Jul 11th 2002
From The Economist print edition



In 1974 David Plowden published a magnificent book of photographs of North America's most ingenious or graceful spans, showing their rich variety of structure (arch, truss, cantilever, suspension) and material (stone, wood, iron, steel, concrete). Now comes an updated version of his classic, “Bridges: The Spans of North America” (Norton; $75)

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About sponsorship

New fiction

Fields of dreams

Jul 11th 2002
From The Economist print edition

AFTER communism collapsed in 1989, Budapest and Prague attracted large numbers of wandering Americans, most of them young. Some came to make a fortune, others to write the great American novel. Few made money, even fewer were published. Arthur Phillips's first novel, which documents the life of John Price, a young American who quit Los Angeles for Budapest circa 1990, comes with much advance praise.

Prague
By Arthur Phillips

Random House; 382 pages; $24.95

Buy it at
Amazon.com

The title refers to the belief of the American characters that everything is better in Prague. The editor of the local paper, *BudapesToday*, for which Price becomes a columnist, admits his rag is no *Prague Post*. “Dude go to Prague, you'll forget this scene in twenty seconds,” is the refrain in the Budapest nightclubs. For heaven's sake get on the train then, one is tempted to say.

Sadly, “Prague” is a novel which does not bear examination. The characters are irritating. “This whole country needs its ass kicked,” says one of them early on, nicely capturing their milieu. Hungarians emerge only in a sub-plot which has Charles Gabor, a sneering Hungarian-American financier, buying a stake in the publishing house of Imre Horvath, whose family had been publishing Hungarian classics long before the communists came along.

Mr Phillips does better in capturing the sense of possibility in Central Europe at the time. Most of the players are here: shady money men, journalists, hookers of Soviet origin, spies-turned-entrepreneurs, idealistic returnees, horny English language teachers. Raising money was easy, Gabor explains to Price: “The hotel lobbies were sloshing with it. You just needed a suit and bucket.”

What makes the novel hard to read is the choppy, off-key writing: “They were kissing, and her tongue felt corpsely cold but humanly soft.” Mr Phillips's Budapest is bereft of thermal baths or imperial decay, and it is peopled with new arrivals who meet only in the Café Gerbeaud (in this city of cafés). Budapest and Prague may have been the Paris of the 1990s for adventurous Americans, but they are still in need of a chronicler.

Prague.
By Arthur Phillips.
Random House; 382 pages; $24.95

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Women in China

Unenviable lives

Jul 11th 2002
From The Economist print edition

IF WESTERN readers have a picture of how women lived in 20th-century China, it probably comes from Jung Chang's “Wild Swans: Three Daughters of China” (1986), about three generations of women before, during and after Mao's Great Revolution. This book is different. It casts its net more widely through the country, and unlike Ms Chang's work, takes in women of all backgrounds as well as all ages—though admittedly still with a preponderance of those old enough to have had their lives turned upside down, if not during the establishment of the People's Republic in 1949, then by the turmoil of the political campaigns that followed.

The Good Women of China
By Xinran

Chatto & Windus; 240 pages; £14.99. To be published in the United States by Pantheon Books in October

Buy it at
Amazon.co.uk

For the eight years before she left for England in 1997, the author presented a radio show called “Words on the Night Breeze” on a state-owned station in the east-central city of Nanjing. The book—its title an echo of Bertolt Brecht's play “The Good Woman of Sezuan”—interweaves the author's own story with a collection of narratives that women listeners left anonymously on the station's answering machines or told to her in person.

Some of the stories would never have been allowed on air in China. One, about a bright-eyed, educated Communist sent on an “urgent mission”, ends with her becoming the girl bride of a senior army officer. Decades later, “when we are alone with each other, all you hear are the noises of animal existence: eating, drinking and going to the toilet. To him, my only function is to serve as evidence of his ‘simplicity, diligence and upright character' so he can move to a higher office.”

The stories—in particular how they reach the broadcaster and how they are told—are often strangely poetic as well as disturbing. One, in particular, is “The Girl Who Kept a Fly as a Pet”, which is recounted through the diary of a teenage girl in the mid-1970s. Having been sexually abused by her father, we are told that she eventually engineers her own death from septicaemia.

Many of the women suffer great physical hardships, such as the Tangshan earthquake that killed 300,000 people in 1976, but it is the tales of women being abused and ill treated by men coarsened by extreme political violence that are the most vivid; they do little for the much-vaunted Communist notion that women in the New China are held in such high esteem that they “hold up half the sky”.

Readers familiar with “Wild Swans” will know about the endless political campaigns and their malign effect on domestic life. Indeed, the author is at her best when talking to women of that era, many of whose lives were buffeted by the political changes but whose preoccupations—with marriage, relationships, sex and raising children—were still often commonplace. Yet the fact is that half the Chinese population is too young to have more than the dimmest memories of the last political upheaval, the cultural revolution, which ended in 1976. It would have been heartening to read more, not just here but elsewhere too, of how women's lives have been affected by the changes since China began opening up two decades ago.

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About sponsorship

Submarine films

Iron coffins

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From The Economist print edition

You've heard of underground movies. Try underwater ones

SUBMARINES may have no women aboard but the combination of emotional compression, claustrophobia and the threat of genital crabs seems to be a winning one for film makers. For three-quarters of a century they have found the genre irresistible. “K-19: The Widowmaker”, which stars Harrison Ford and Liam Neeson and which opens in America on July 19th, is the latest.

The story of the Soviet nuclear sub that came within an inch of total meltdown while patrolling off the American coast at the height of the cold war in 1961, breaks new ground in two ways. The film was made in Hollywood, but it is the first to depict what happened from a Russian perspective and it was shot with full co-operation from America's former enemy. It is also the first such film to be directed by a woman. Kathryn Bigelow's career embraces a stream of macho films, including “Blue Steel” (1989), “Point Break” (1991) and “Strange Days” (1995). Formerly married to James Cameron, who made “Titanic”, she seems to have been compelled ever since to emulate and even surpass her one-time spouse. The ticking-clock factor in “K-19” plays to her strengths.

Unnatural though it may seem, the notion of gliding, silent, unseen and underwater, has had a magnetic pull since before submarines were invented. Jules Verne's “20,000 Leagues Under the Sea”, a work of late-19th-century science fiction, was given special nobility by Captain Nemo's quest for a better, non-violent life. When Richard Fleischer made a film version for Walt Disney in 1954, he preserved this philosophical undertone, with James Mason perfectly cast as the enigmatic hero.

Since then, submarines have featured mostly as vessels of war. Undersea melodramas with no thought but bashing the enemy as well as the guy who's trying to steal your girl are legion. “Crash Dive” (1943), had Tyrone Power and Dana Andrews fighting on land and sea over the charms of Anne Baxter. Samuel Fuller's “Hell and High Water” (1954) was a nervily shot and edited undersea thriller with Richard Widmark. The battle of wills between Clark Gable and Burt Lancaster in “Run Silent, Run Deep” (1958) had a hard-edged naval feel, but could just as easily have been set on Madison Avenue.

John Mills, a British actor, specialised in playing submarine commanders under pressure. In “Above Us the Waves” (1955) his fleet of mini-subs was sent to sink a German battleship. In “Morning Departure” (1950), a moving adaptation of the play, he was the commander faced with a horrible decision: his sub has been crippled by a mine and only eight of the initial 12 survivors can escape. In this, as in all submarine films, the viewer is gripped by one of the great primal fears: will those onboard succeed in getting out before the water gets in; if not, then what?

In 1933, German film studios could still make semi-pacifist films such as “Morgenrot”. Here a U-boat sinks a British cruiser but family members of the German crew, rather than rejoicing at the drowning British sailors, are instead moved by their fate.

Its nearest second-world-war equivalent, “Das Boot”, was made by Wolfgang Petersen in 1981, a comfortable distance from Germany's wartime defeat. This was life aboard a U-boat during the Battle of the Atlantic, when German submarines destroyed 15m tonnes of Allied shipping, with the loss of more than 50,000 British lives. Forty years later, Mr Petersen does not celebrate German prowess so much as the guts required to do a difficult job well in cramped conditions. He makes magisterial use of the prowling Steadicam camera to underline the physical discomfort of the vessel. The uneven pop of the hull's rivets exploding one by one as the pressure mounts on the crippled vessel is enough to make any viewer's heart race. And when the captain, played by the mournful Jürgen Prochnow, is killed as he is about to be reunited with his family, your already leaden heart only sinks further.

“Das Boot” is great entertainment, employing cinema's most sophisticated techniques to mirror the experience of life beneath the waves, though for the real war at sea, viewers should turn instead to Andrew Williams's three-part documentary “The Battle of the Atlantic”, which is being broadcast on the BBC this month. Drawing on interviews with surviving U-boat crews, the documentary highlights many of the elements that make submarines such compelling film sets: the cramped, sweaty conditions under which the German submariners worked, the spirit of brotherhood that kept them going, which was matched by the courage of allied naval forces and loyalty on the home front in resisting Germany's determined attempt to starve Britain into submission.

The cold war yielded surprisingly few submarine movies, though one memorable exception was Tony Scott's “Crimson Tide” (1995), a nuclear submarine melodrama which turned on the receipt of a garbled message that might or might not mean the start of the third world war. Meanwhile, in her new film “K-19”, Kathryn Bigelow combines gravitas, sweat and suspense—all in the same frame. And at the edge of it, the ever-present threat of water pouring in.

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Duke of Norfolk

Jul 11th 2002
From The Economist print edition

The duke of Norfolk, an English survivor, died on June 24th, aged 86

AP

MANY thousands of words have been written during the past couple of weeks about a soldier who inherited the title of the duke of Norfolk and with it the duties of earl marshal and chief butler of England. Readers of the *Times* were offered some 2,200 words. Newspapers catering for less patient readers made do with snappy accounts of the duke's soldierly habit of cleaning his own shoes. Perhaps that was enough to make a point. The more distant you were from the world in which the duke moved, the more peculiar it seemed.

The duke himself seemed aware of his title's growing irrelevance. He was perhaps the least ducal of the 17 holders of the title created by Richard III in 1483 (or possibly only 16; there is some dispute among the archivists). Succeeding by death, the duke said, was “a poor way of getting on” and he was prouder to have made his way to become a general. The duke upset some fellow members of the House of Lords by agreeing that those with inherited seats should no longer be involved in lawmaking, although he retained his own seat, as did the member who had the duties of the lord great chamberlain.

His rebelliousness had its limits. Like many associated with archaic institutions, the duke was a charming contradiction. He epitomised old values, country, family, faith, without being stuffy about it. Tradition, he said, was one of the reasons that the country had not had a revolution since 1688 and had not been successfully invaded since 1066. That was a very British thing to say. Whatever its merits as an argument, it expressed a sentiment that drives the enormously popular history programmes on British television and perhaps also drove the royal feeling that unexpectedly swept the country when the Queen Mother died in March, moving those of a republican mind to silence. For anyone seeking to explore, if not to understand, the appeal of “this sceptred isle”—a long-running programme on BBC radio—the career of the country's premier duke was at least worth a look.

Into battle

At birth he was merely the Honourable Miles Francis Fitzalan-Howard, “honourable” being a politeness conferred on the child of a lord. In what he called the “wavy line of the succession” he later became Lord Beaumont, then Lord Howard, and finally, when a distant cousin died, found that he had become the duke of Norfolk. “I was never sure what I would be called next,” he said. “Miles” usually sufficed.

At the age of 22 he joined the Grenadier Guards (raised in 1656). Two years later, at the start of the second world war, his mother made the sign of the cross on his forehead and he went off to France in command of an anti-tank platoon. He had an exemplary war, serving on the battlefields of Europe and North Africa. He gained a reputation for, in Hemingway's phrase for bravery, showing grace under fire. He stayed on in the army after the war until 1967 when he worked part time for Robert Fleming, a merchant bank with family connections.

In his army days he had bought a house in Oxfordshire, and preferred it to the edifices he eventually inherited in 1975 as duke of Norfolk, particularly Arundel Castle in Sussex, the ducal seat, nearly 1,000 years old, brimming with history, but mostly comfortless. More agreeable was his duty as earl marshal, choreographing the annual opening of Parliament by the monarch, a ceremony largely unchanged since medieval times.

Everyone agreed that he brought a soldierly efficiency to the event, in which he had to walk backwards before the queen without tripping. When his scarlet uniform became a bit tatty he asked Dennis Healey, the chancellor of the exchequer in the then Labour government, if it would pay for a replacement. Mr Healey nodded through the expense. The two men had first met fighting in Italy in the war.

He possessed robes that had been made for his great-great grandfather when a ban was lifted in 1829 on Roman Catholics sitting in Parliament. The survival of the Howard family in Protestant England dating from Henry VIII is regarded by historians as an example of tenacity and by many Catholics as miraculous. Some ancestors went under the axe, including Henry Howard, a Tudor poet much admired by the duke. Philip Howard was believed to have been poisoned and was made a saint. The duke was said to keep a book of prayers in his jacket. “We are like the British infantry in defence,” he said. “We never give in.”

These days the politics of Christianity arouse little general interest in Britain. “We are all so ecumenical and love each other,” the duke said. “I am terribly ecumenical myself.” He disagreed with the Vatican's opposition to birth control, but so do many Catholics. “Has every wife got to have eight children like my mother?” he said, and his listeners agreed. He enjoyed an argument but didn't much care for parties. What he mostly liked was working in the open, repairing walls, managing woodland. “I wish I was thinning trees,” he was heard to say at a dinner party. He told of a party he had given for European royals who stayed on until three in the morning. “You might have thought some people hadn't got palaces to go to,” he said.

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Overview

Jul 11th 2002
From The Economist print edition

Hopes of an early economic recovery in the **euro area's** biggest economy receded. German industrial production was expected to rise in May; instead, it fell by 1.3%, thanks in part to striking workers. German unemployment rose to 9.8% in June, from 9.7% in May. Dutch consumer prices rose by 3.4% in the year to June.

Germany's jobless are not alone. Unemployment in **America** rose to 5.9% in June, from 5.8% in May.

Stockmarkets continued to slide all round the world. America's Dow Jones Industrial Average closed below 9,000 for the first time since October 2001, and the Nasdaq sank to its lowest level since May 1997.

Japanese retail sales fell by 2.2% in the year to May, a slightly smaller fall than in the previous month. Wholesale prices were flat in June, for the fourth month in a row.

Britain's trade deficit narrowed to $45.6 billion as exports surged in the year to May. Exports to countries beyond the EU were particularly strong, growing by 15.1% from April to May. Britain's industrial production grew by 0.9% in May, its second straight month of growth.

The **dollar** slid against the euro, and came again within a cent of parity, for the third time in two weeks.

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Output, demand and jobs

Jul 11th 2002
From The Economist print edition

% change at annual rate

	GDP 1 qtr	GDP 1 year		The Economist poll GDP forecasts 2002	2003	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		year ago
Australia	+ 3.6	+ 4.2	Q1	+ 4.0	+ 3.9	+ 4.3	Q1	+ 5.0	Q1	6.5	Jun	6.9
Austria	– 0.7	– 0.4	Q4	+ 1.2	+ 2.6	+ 3.5	Apr	+ 0.2	Mar	4.1	May	3.5
Belgium	+ 2.0	– 0.3	Q1	+ 1.4	+ 3.1	– 2.5	May	+ 1.8	Apr	10.4	Jun*	9.9
Britain	+ 0.7	+ 1.1	Q1	+ 1.7	+ 3.0	– 1.9	May	+ 5.4	May	5.2	Apr†	5.0
Canada	+ 6.0	+ 2.1	Q1	+ 3.2	+ 3.6	+ 1.3	Apr	+ 5.1	Apr	7.5	Jun	7.0
Denmark	+ 1.4	+ 1.1	Q1	+ 1.6	+ 2.4	+ 2.5	May	+ 1.5	Apr	5.1	May	5.2
France	+ 1.4	+ 0.3	Q1	+ 1.4	+ 2.9	+ 0.9	Apr	+ 2.3	May	9.1	May	8.6
Germany	+ 0.7	– 1.2	Q1	+ 0.9	+ 2.6	– 3.9	May	– 4.6	May	9.8	Jun‡	9.3
Italy	+ 0.6	+ 0.1	Q1	+ 1.2	+ 2.8	+ 0.5	Apr	– 1.2	Apr	9.0	Apr	9.5
Japan	+ 5.7	– 1.6	Q1	– 0.4	+ 1.2	– 2.2	May	– 2.2	May	5.4	May	4.9
Netherlands	nil	nil	Q1	+ 1.2	+ 2.8	– 5.6	Apr	+ 3.3	Apr	2.3	May§	1.9
Spain	+ 2.1	+ 2.0	Q1	+ 2.2	+ 3.3	– 1.7	May	na		11.4	May**	10.6
Sweden	+ 1.1	+ 1.1	Q1	+ 1.7	+ 2.9	+ 0.4	Apr	+ 4.9	May	3.4	May*	3.5
Switzerland	+ 0.7	+ 0.2	Q1	+ 1.1	+ 2.3	– 8.8	Q1	+ 4.3	Apr	2.5	Jun*	1.6
United States	+ 6.1	+ 1.7	Q1	+ 2.8	+ 3.5	– 1.6	May	+ 4.9	May	5.9	Jun	4.6
Euro area	+ 0.9	+ 0.3	Q1	+ 1.2	+ 2.8	– 1.2	Apr	+ 0.1	Apr	8.3	May**	8.0
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	– 0.6	– 2.0	Q1	na	na	+ 0.2	May	+ 2.0	Mar	11.9	May*	11.3
Greece	na	+ 4.3	Q1	na	na	+ 4.9	Apr	+19.3	Mar	na		na
Iceland	na	+ 3.1	2001	na	na	+ 3.3	2001	na		2.5	May*	1.6
Ireland	na	nil	Q4	na	na	– 3.3	Apr	– 0.5	Apr	4.3	Jun	3.7
Luxembourg	na	+ 3.5	2001	na	na	+ 8.8	Apr	+ 9.9	Feb	2.8	Apr	2.5
New Zealand	+ 4.3	+ 4.0	Q1	na	na	+ 4.3	Q1	+ 8.2	Q1	5.3	Q1	5.4
Norway	– 1.1	+ 1.0	Q1	na	na	+ 7.9	May	+ 2.7	May	4.1	Q1	3.7
Portugal	+ 1.8	+ 1.0	Q4	na	na	+ 0.8	May	+ 0.5	May	4.4	Q1*	4.2

*Not seasonally adjusted. †Feb-Apr; claimant count rate 3.1% in May. ‡EU harmonised rate 8.3%. §Mar-May. **Revised series.

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Prices and wages

Jul 11th 2002
From The Economist print edition

% change at annual rate

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2002	2003	latest		year ago	latest		year ago
Australia	+ 2.9	Q1	+ 6.0	+ 2.7	+ 2.6	+ 0.5	Q1	+ 5.2	+ 4.3	Q1	+ 5.6
Austria	+ 1.9	May	+ 3.4	+ 1.8	+ 1.7	– 1.7	Jun	+ 2.9	+ 2.4	May	+ 2.7
Belgium	+ 0.9	Jun	+ 2.9	+ 1.9	+ 1.6	+ 2.4	May	+ 1.7	+ 2.6	Q2	+ 2.6
Britain	+ 1.1	May	+ 2.1	+ 2.1	+ 2.5	nil	Jun	+ 0.4	+ 3.3	Apr	+ 5.2
Canada	+ 1.0	May	+ 3.9	+ 1.7	+ 2.2	– 2.6	May	+ 2.8	+ 2.8	Apr	+ 1.5
Denmark	+ 2.2	Jun	+ 2.3	+ 2.3	+ 2.1	– 0.3	May	+ 2.9	+ 4.0	Q1	+ 3.8
France	+ 1.4	May	+ 2.3	+ 1.8	+ 1.5	– 1.5	May	+ 2.8	+ 3.9	Q1	+ 4.3
Germany	+ 0.8	Jun	+ 3.1	+ 1.5	+ 1.4	– 1.3	May	+ 4.0	+ 2.1	Apr	+ 1.5
Italy	+ 2.2	Jun	+ 3.0	+ 2.3	+ 2.0	– 0.9	May	+ 2.9	+ 2.3	Apr	+ 2.6
Japan	– 0.9	May	– 0.7	– 1.0	– 0.4	– 1.0	Jun	+ 0.8	– 0.5	May	– 0.1
Netherlands	+ 3.4	Jun	+ 4.5	+ 3.6	+ 2.5	– 0.7	Apr	+ 6.2	+ 3.2	May	+ 4.9
Spain	+ 3.4	Jun	+ 4.2	+ 3.3	+ 2.8	+ 0.6	May	+ 2.7	+ 4.0	Q1	+ 3.4
Sweden	+ 2.0	May	+ 3.0	+ 2.4	+ 2.1	– 0.2	May	+ 2.6	+ 2.0	Apr	+ 3.1
Switzerland	+ 0.3	Jun	+ 1.6	+ 0.8	+ 1.2	– 1.4	May	+ 0.4	+ 2.5	2001	+ 1.3
United States	+ 1.2	May	+ 3.6	+ 1.7	+ 2.3	– 2.7	May	+ 3.9	+ 3.3	Jun	+ 4.1
Euro area	+ 1.7	Jun	+ 3.0	+ 2.2	+ 1.8	– 0.9	May	+ 3.7	+ 3.3	Q1	+ 2.8
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 1.3	May	+ 3.3	na	na	– 1.6	May	+ 2.1	+ 3.2	Q1	+ 5.1
Greece	+ 3.3	Jun	+ 3.9	na	na	+ 3.1	Apr	+ 5.1	na		na
Iceland	+ 4.1	Jul	+ 7.0	na	na	+ 7.1	Jun	+ 5.9	+ 7.5	May	+ 8.0
Ireland	+ 4.7	May	+ 5.4	na	na	+ 0.3	May	+ 3.4	+ 8.9	Q1	+ 7.4
Luxembourg	+ 1.7	Jun	+ 2.9	na	na	– 2.5	Apr	+ 2.6	nil	Apr	+ 8.4
New Zealand	+ 2.6	Q1	+ 3.1	na	na	+ 2.8	Q1	+ 8.0	+ 2.1	Q1	+ 1.8
Norway	+ 0.4	Jun	+ 3.8	na	na	–15.8	Jun	+ 3.5	+ 4.6	Q1	+ 4.4
Portugal	+ 3.3	May	+ 4.8	na	na	– 2.0	May	+ 5.5	na		na

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Portfolio poll

Jul 11th 2002
From The Economist print edition

Portfolio poll

2nd quarter 2002

▼▲ A change of 5% points or more on last quarter ▼▲ A change of less than 5% points on last quarter

	Holdings by instrument, %			Equity holdings by area, %						
	Equities	Bonds	Cash	United States	Other Americas	Britain	Euro area	Other Europe	Japan	Other Asia
Robeco Group	53	47	0	52▼	2	11▲	15	5	11▲	4
Julius Baer PB	35▼	51▲	14†▼	45▼	8▲	7	16▲	8▲	8▲	8▲
Commerz Int. CM	60▲	40▼	0	53	1	11▲	19▼	3▲	11	2
Credit Suisse PB	40	35	25‡	57▼	0	11	16	4▲	10	2
Lehman Brothers	70	30	0	35▼	0	7	28▼	7▲	14▲	9
Standard Life	55	45	0	56▼	0	12▲	15▼	4	9▲	4
Daiwa IR	60▼	34▲	6▲	52▼	1▼	10	20	4▲	10▲	3▲
Average	53▼	40▲	6	50▼	2▲	10▲	18▼	5▲	10▲	5▲
Neutral*				55▼	3▲	11▲	14▼	5	9	3

	Bond holdings by currency, %				
	Dollar	Yen	Sterling	Euro-zone	Others
Robeco Group	28▼	19▼	5▼	46▲	2▼
Julius Baer PB	88	0	0	7▲	5▼
Commerz Int. CM	52▲	16▼	16▲	14▼	2▼
Credit Suisse PB	83▲	0	0	17▼	0
Lehman Brothers	47▼	18	4	28▲	3
Standard Life	25▼	29▲	5	39▲	2▼
Daiwa IR	29▼	14▲	6▲	47	4
Average	50▲	14▼	5▲	28▲	3▼
Neutral*	23▼	29▲	5	38▲	5▼

*Morgan Stanley Capital International (developed) world equity index; Salomon Brothers world government-bond index
†Of which 5% invested in alternative investments
‡Of which 17% invested in alternative investments

According to this quarter's portfolio poll, only Commerzbank has not lost faith in America's companies following the slew of recent accounting scandals. All of the other fund managers in our poll are sellers of American equities. One of the biggest beneficiaries of the asset shift is Japan. Interestingly, continental European countries outside the euro-zone are also favourites with fund managers this quarter, but the economically weightier countries inside the euro area are not. Globally, equities are less popular and bonds are back in style, though a narrow majority of managers are leaving allocations unchanged. Good news for the euro, however: a majority of our investors are raising their holdings of euro-denominated bonds, mostly at the expense of dollar-denominated bonds.

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Money and interest rates

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From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Jul 10th 2002)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 3.7	+14.9	May	4.95	5.04	5.36	5.95	6.08	7.02‡
Britain	+ 9.1	+ 6.0	May	4.03	5.19	4.60	5.04	5.08	6.09
Canada	+13.6	+ 5.5	May	2.85	4.24	3.76	5.41	5.89	7.11
Denmark	+ 7.4	+ 8.3	May	3.75	5.03	4.41	5.13	5.27	6.92
Japan	+32.1	+ 3.4	Jun	0.03	0.01	0.02	1.29	1.28	1.38
Sweden	+ 2.5	+ 7.3	Apr	4.29	4.35	4.84	5.36	5.37	5.41
Switzerland	+ 4.1	+ 3.0	May	1.18	3.23	1.77	3.08	3.36	4.22
United States	+ 5.9	+ 7.8	May	1.76	3.62	2.59	4.64	5.29	6.73
Euro area†	+ 7.0	+ 7.8	May	3.42	4.46	3.87	4.87	4.97	5.94

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. ‡New series. Benchmarks: US 30-year 5.36%, Japan No.240 1.29%. Central bank rates: US fed funds 1.75%, ECB refinancing 3.25%, BOJ overnight call 0.001%, BOE repo 4.00%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS Warburg, DRI-WEFA, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Jul 11th 2002
From The Economist print edition

1995=100

	Jul 2nd	Jul 9th*	% change on one month	% change on one year
Dollar index				
All items	70.6	72.6	+ 3.8	+ 5.7
Food	70.6	73.5	+ 4.4	+ 8.2
Industrials				
All	70.5	71.4	+ 3.1	+ 2.5
Nfa†	73.2	72.8	+ 4.9	+ 6.8
Metals	68.3	70.1	+ 1.6	– 1.0
Sterling index				
All items	74.2	74.8	– 0.8	– 2.8
Euro index				
All items	95.7	96.8	– 0.6	– 9.2
Yen index				
All items	91.5	92.8	+ 0.7	+ 2.0
Gold				
$ per oz	318.35	314.25	– 3.4	+17.1
West Texas Intermediate				
$ per barrel	26.30	26.86	+ 8.0	+ 2.1

* Provisional. † Non-food agriculturals.

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Stockmarkets

Jul 11th 2002
From The Economist print edition

Market indices

	Jul 10th	2002 high	2002 low	% change on one week	% change on record high	% change on Dec 31st 2001 in local currency	% change on Dec 31st 2001 in $ terms
Australia (All Ordinaries)	3,175.2	3,440.0	3,129.7	+ 1.4	– 7.7	– 5.5	+ 4.5
Austria (ATX)	1,219.7	1,357.2	1,114.4	– 0.2	–29.8	+ 7.0	+18.6
Belgium (Bel 20)	2,435.6	2,899.8	2,402.2	+ 1.1	–33.8	–12.5	– 2.9
Britain (FTSE 100)	4,420.1	5,323.8	4,392.6	+ 0.6	–36.2	–15.3	–10.0
Canada (Toronto Composite)	6,916.4	7,958.1	6,916.4	– 1.5	–39.3	–10.0	– 5.6
Denmark (KBX)	202.5	233.4	196.3	+ 0.7	–32.9	– 9.9	– 0.0
France (SBF 250)	2,451.5	3,081.9	2,425.1	+ 1.1	–44.2	–17.8	– 8.8
(CAC 40)	3,656.4	4,688.0	3,623.3	+ 0.9	–47.2	–20.9	–12.3
Germany (Xetra DAX)	4,190.2	5,462.6	4,099.1	+ 1.3	–48.0	–18.8	– 9.9
Italy (BCI)	1,258.0	1,513.0	1,219.0	+ 1.9	–42.4	–12.2	– 2.7
Japan (Nikkei 225)	10,752.7	11,979.9	9,420.9	– 0.6	–72.4	+ 2.0	+13.2
(Topix)	1,037.3	1,139.4	922.5	– 0.7	–64.0	+ 0.5	+11.6
Netherlands (AEX)	409.8	531.2	406.1	+ 0.9	–41.6	–19.1	–10.3
Spain (Madrid SE)	717.3	848.1	696.2	+ 3.0	–37.4	–13.0	– 3.5
Sweden (Affarsvarlden Gen)	173.3	236.8	166.1	+ 1.9	–56.7	–25.1	–16.3
Switzerland (Swiss Market)	5,775.5	6,694.1	5,594.2	+ 1.1	–31.3	–10.0	+ 0.2
United States (DJIA)	8,813.5	10,635.3	8,813.5	– 2.7	–24.8	–12.1	–12.1
(S&P 500)	920.5	1,172.5	920.5	– 3.5	–39.7	–19.8	–19.8
(Nasdaq Comp)	1,346.0	2,059.4	1,346.0	– 2.5	–73.3	–31.0	–31.0
Europe (FTSE Eurotop 300)*	1,025.8	1,279.7	1,013.8	+ 1.2	–39.8	–18.7	– 9.8
Euro area (FTSE Ebloc 100)*	883.1	1,125.1	869.4	+ 1.6	–43.0	–20.6	–11.9
World (MSCI)†	862.3	1,024.4	862.3	– 1.3	–40.5	na	–14.1
World bond market (Salomon)‡	487.1	487.1	430.3	+ 1.0	nil	na	+10.8

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms.
‡Salomon Smith Barney World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Jul 11th 2002
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current account $bn latest 12 mths		The Economist poll % of GDP, forecast 2002	2003	Exchange rate trade-weighted† Jul 10th	year ago	Currency units per $ Jul 10th	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2002‡
Australia	+ 0.4	May	− 9.5	Q1	− 3.3	− 3.6	74.9	72.0	1.77	1.97	2.73	1.74	1.50	0.1
Austria	− 2.6	Mar	− 2.5	Apr	− 2.2	− 2.0	100.8	99.9	1.01	1.16	1.57	–	0.86	-0.3
Belgium	+ 12.2	Apr	+ 13.0	Dec	+ 5.0	+ 5.3	100.2	98.3	1.01	1.16	1.57	–	0.86	nil
Britain	− 45.6	May	− 31.2	Q1	− 2.2	− 2.1	105.1	107.1	0.65	0.71	–	0.64	0.55	-0.8
Canada	+ 35.6	Apr	+ 14.7	Q1	+ 2.2	+ 2.3	78.0	79.0	1.52	1.53	2.35	1.50	1.29	1.0
Denmark	+ 7.0	Apr	+ 3.5	Apr	+ 1.9	+ 1.9	103.2	101.6	7.52	8.64	11.6	7.43	6.37	2.2
France	+ 7.1	Apr	+ 24.9	Apr	+ 1.8	+ 1.7	103.0	100.9	1.01	1.16	1.57	–	0.86	-2.0
Germany	+ 96.5	May	+ 19.8	May	+ 1.1	+ 1.1	100.1	97.8	1.01	1.16	1.57	–	0.86	-2.8
Italy	+ 8.3	Apr	− 0.3	Mar	+ 0.1	nil	73.5	72.0	1.01	1.16	1.57	–	0.86	-1.4
Japan	+ 73.5	Apr	+ 97.4	Apr	+ 2.7	+ 2.7	136.7	137.7	118	124	183	117	–	-8.0
Netherlands	+ 22.8	Apr	+ 13.6	Q1	+ 4.0	+ 4.1	99.2	97.2	1.01	1.16	1.57	–	0.86	0.1
Spain	− 36.8	Apr	− 15.3	Mar	− 2.2	− 1.9	75.1	73.8	1.01	1.16	1.57	–	0.86	-0.3
Sweden	+ 14.6	May	+ 7.6	Apr	+ 3.2	+ 3.3	76.4	74.4	9.4	10.8	14.5	9.26	7.95	2.1
Switzerland	+ 2.3	May	+ 25.7	Q1	+ 9.8	+10.1	113.8	107.9	1.49	1.76	2.31	1.47	1.26	na
United States	−423.2	Apr	−398.1	Q1	− 4.3	− 4.6	112.0	120.7	–	–	1.55	0.99	0.85	-1.0
Euro area	+ 65.5	Apr	+ 16.0	Apr	+ 0.4	+ 0.5	81.9	77.2	1.01	1.16	1.57	–	0.86	-1.5
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 12.1	Apr	+ 7.4	Apr	na	na	79.2	77.7	1.01	1.16	1.57	–	0.86	3.2
Greece	− 19.1	Dec	− 6.7	Mar	na	na	58.0	57.1	1.01	1.16	1.56	–	0.86	0.4
Iceland	+ 0.1	May	− 0.2	Q1	na	na	na	na	86.1	102	133	85.0	72.9	-0.5
Ireland	+ 33.2	Apr	− 1.1	Q4	na	na	89.5	86.2	1.01	1.16	1.56	–	0.86	0.1
Luxembourg	− 2.9	Apr	+ 0.9	Q4	na	na	100.2	98.3	1.01	1.16	1.56	–	0.86	2.2
New Zealand	+ 0.1	May	− 1.2	Q1	na	na	88.4	78.5	2.04	2.47	3.15	2.01	1.73	0.1
Norway	+ 25.1	May	+ 25.9	Apr	na	na	106.8	95.4	7.38	9.27	11.4	7.29	6.25	14.0
Portugal	− 12.9	Apr	− 9.8	Apr	na	na	90.1	88.9	1.01	1.16	1.56	–	0.86	-2.4

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †1990=100, Bank of England. ‡OECD forecast.

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Commercial property prices

Jul 11th 2002
From The Economist print edition

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Overview

Jul 11th 2002
From The Economist print edition

Brazil's industrial production fell by 5.1% in May, the biggest monthly drop since mid-1995. Compared with a year ago, industrial output slid by 0.9%.

Czech consumer prices rose by 1.2% in the year to June, less than analysts expected.

Russia's stockmarket rose by 8.9% as Standard & Poor's suggested that it would soon upgrade Russia's credit rating.

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Poverty in Africa

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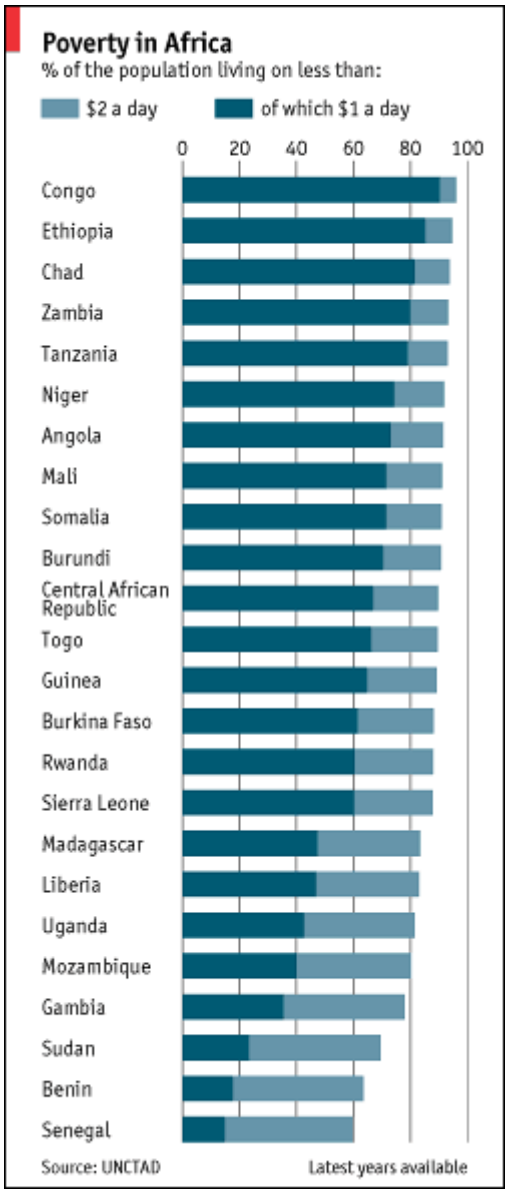
From The Economist print edition

In much of Africa, poverty is pervasive. Almost nine out of ten people in Africa's poorest countries live on less than $2 a day (in purchasing-power terms) and two-thirds survive on less than $1 a day, according to a report from the United Nations Conference on Trade and Development (UNCTAD). In Congo, personal consumption among the poorest averages $0.38 per day. Amid such deep poverty, aid schemes should aim for overall economic growth, rather than concentrating only on the poorest people, argues the report.



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Economy

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	% change on year earlier						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 7.6	Q1	+12.4	Jun	– 1.1	May	+25.8	May	+21.2	2001§	230.9	Mar
Hong Kong	– 0.9	Q1	–11.6	Q1	– 3.1	May	– 8.8	May	+14.5	Q1	112.4	Jun
India	+ 6.4	Q1	+ 2.9	Apr	+ 4.7	May	– 5.7	May	+ 1.4	Q1	54.7	Jun
Indonesia	+ 2.5	Q1	– 4.3	Q3	+11.5	Jun	+26.9	May	+ 7.3	Q3	27.9	May
Malaysia	+ 1.1	Q1	+ 4.0	May	+ 1.6	May	+13.2	May	+ 7.0	Q1	32.6	May
Philippines	+ 3.8	Q1	+17.0	Apr	+ 3.0	Jun	+ 2.3	Apr	+ 5.2	Mar	14.1	Jun
Singapore	– 1.7	Q1	+17.0	May	– 0.3	May	+ 6.1	May	+18.4	Q1	80.4	Jun
South Korea	+ 5.7	Q1	+ 7.7	May	+ 2.6	Jun	+ 8.7	Jun	+ 5.9	May	109.6	May
Taiwan	+ 0.9	Q1	+10.1	May	+ 0.1	Jun	+18.6	Jun	+22.0	Q1	148.2	Jun
Thailand	+ 3.9	Q1	+ 8.4	May	+ 0.2	Jun	+ 4.2	May	+ 6.5	May	34.5	May
Argentina	–16.3	Q1	–14.3	May	+28.4	Jun	+11.8	May	nil	Q1	10.2	May
Brazil	– 0.7	Q1	– 0.9	May	+ 7.8	May	+ 5.3	Jun	–19.0	May	32.9	May
Chile	+ 1.5	Q1	– 3.8	May	+ 2.0	Jun	+ 2.2	May	– 1.0	Q1	15.0	May
Colombia	+ 0.5	Q1	+ 7.8	Apr	+ 6.3	Jun	+ 0.6	Mar	– 1.4	Q1	10.5	May
Mexico	– 2.0	Q1	+ 8.0	Apr	+ 4.9	Jun	– 9.2	May	–16.8	Q1	44.9	May
Peru	+ 4.3	May	+ 8.6	Apr	– 0.2	Jun	– 0.1	Apr	– 1.0	Q1	8.7	May
Venezuela	– 4.2	Q1	–20.0	Mar	+19.6	Jun	+ 8.0	Q1	+ 1.8	Q1	6.7	Apr
Egypt	+ 4.9	2001†	+ 7.8	2001†	+ 2.7	Apr	– 8.6	Jan	– 0.1	Q1	12.6	Mar
Israel	– 4.2	Q1	– 3.5	Apr	+ 5.5	May	– 5.8	May	– 2.3	Q1	24.8	Jun
South Africa	+ 2.1	Q1	+ 6.8	May	+ 8.4	May	+ 3.8	May	– 0.1	Q1	5.9	May
Turkey	+ 2.3	Q1	+11.0	May	+42.6	Jun	– 8.9	Apr	+ 2.6	Apr	22.0	May
Czech Republic	+ 2.5	Q1	+ 8.2	Apr	+ 1.2	Jun	– 2.5	May	– 2.4	Q1	21.2	Jun
Hungary	+ 2.9	Q1	– 0.7	May	+ 4.8	Jun	– 2.4	May	– 1.8	May	9.8	May
Poland	+ 0.5	Q1	– 4.1	May	+ 1.9	May	–10.8	May	– 7.1	May	26.4	May
Russia	+ 3.7	Q1	+ 2.8	May	+14.9	Jun	+44.8	Apr	+31.2	Q1	39.8	Jun
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Pakistan	+ 3.3	2001†	–10.1	Feb	+ 2.9	May	– 1.1	May	+ 0.3	2001†	4.1	May
Saudi Arabia	+ 1.2	2001	na		nil	Mar	+44.1	2001	+14.5	2001	18.4	May

*Excluding gold, except Singapore; IMF definition. †Year ending June. §Economist Intelligence Unit estimate.

Text refers only to the first 25 countries listed

Sources: National statistics offices, central banks and stock exchanges; Thomson Financial Datastream; Economist Intelligence Unit; Reuters; Warburg Dillon Read; J.P Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Garanti Bank; Deutsche Bank; *Russian Economic Trends*.

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Financial markets

Jul 11th 2002
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Jul 10th		Dec 31st 2001	
	Jul 10th	year ago	Jul 10th	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	12.8	na	1,776.2	– 1.7	+ 3.7	+ 3.7
Hong Kong	7.80	7.80	12.1	1.81	10,787.5	+ 2.0	– 5.3	– 5.4
India	48.8	47.2	75.4	6.13	3,332.4	+ 0.7	+ 2.1	+ 1.0
Indonesia	8,908	11,340	13,774	15.87	477.4	– 0.2	+ 21.8	+ 42.2
Malaysia	3.80	3.80	5.88	3.25	743.2	+ 0.5	+ 6.8	+ 6.8
Philippines	50.2	53.1	77.7	6.69	1,153.1	+ 1.0	– 1.3	+ 1.4
Singapore	1.75	1.84	2.71	0.75	1,631.9	+ 3.1	+ 0.5	+ 6.0
South Korea	1,169	1,307	1,808	4.95	794.7	+ 5.5	+ 14.6	+ 28.7
Taiwan	33.1	35.0	51.2	2.10	5,262.0	+ 4.2	– 5.2	+ 0.1
Thailand	41.2	45.6	63.7	2.13	403.0	+ 2.0	+ 32.6	+ 42.5
Argentina	3.52	1.00	5.44	44.50	385.0	+ 3.6	+ 30.3	– 63.0
Brazil	2.86	2.54	4.42	18.39	10,555.9	– 0.7	– 22.3	– 37.1
Chile	699	666	1,080	3.72	4,851.5	– 1.4	– 10.1	– 14.9
Colombia	2,482	2,311	3,838	8.19	1,226.3	+ 0.1	+ 14.5	+ 5.1
Mexico	9.83	9.28	15.2	7.24	6,371.3	+ 0.7	nil	– 6.7
Peru	3.54	3.51	5.48	3.22	1,130.5	+ 1.9	– 3.8	– 6.5
Venezuela	1,316	720	2,034	25.00	7,202.0	– 0.5	+ 9.6	– 36.9
Egypt	4.63	3.95	7.16	7.20	5,284.9	– 0.6	+ 0.2	– 1.0
Israel	4.71	4.20	7.29	6.40	361.7	+ 4.3	– 19.1	– 24.2
South Africa	10.0	8.26	15.4	12.35	10,313.5	– 0.1	– 1.2	+ 18.7
Turkey	1,662,500	1,380,000	2,570,724	44.00	8,916.5	– 1.0	– 35.3	– 43.4
Czech Republic	29.3	39.4	45.3	3.40	434.0	+ 8.5	+ 10.0	+ 33.5
Hungary	253	299	392	9.68	7,588.4	+ 1.8	+ 6.4	+ 15.4
Poland	4.16	4.39	6.44	9.04	13,990.0	+ 0.6	+ 0.5	– 4.6
Russia	31.6	29.2	48.8	23.00	391.2‡	+ 8.9	+ 55.8	+ 50.4
EMF (MSCI)*	1.00	1.00	1.55	na	327.7	+ 3.5	na	+ 3.2
EMBI+†	1.00	1.00	1.55	na	202.0	+ 1.9	na	+ 0.8

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡ In $ terms.

Sources: National statistics offices, central banks and stock exchanges; Thomson Financial Datastream; Economist Intelligence Unit; Reuters; Warburg Dillon Read; J.P Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Garanti Bank; Deutsche Bank; *Russian Economic Trends.*

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